TIMING OF HEADQUARTERS

Monday to Friday
Office timings 9.00 A.M. to 5.30 P.M.

Public dealing timings
Without financial transactions 9.30 A.M. to 5.00 P.M.
With financial transactions 9.30 A.M. to 4.00 P.M.

Phones: 41504444, 45341000

Grams: COMPSEC

Fax: 011-24626727

Website: www.icsi.edu

E-mail: info@icsi.edu
<table>
<thead>
<tr>
<th>EXECUTIVE PROGRAMME</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAX LAWS</td>
</tr>
</tbody>
</table>

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

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

The purpose of this study material is to impart conceptual understanding to the students of the provisions of the Direct and Indirect Tax Laws covered in the Syllabus. The study material contains all relevant amendments made upto Finance Act, 2011 and is applicable for the Assessment Year 2012-13 relevant for the June 2012 and December 2012 sessions of examination. However, it may so happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore, advised to refer to the Student Company Secretary bulletin and other publications for updation of the study material.

The students may note that Assessment Year for June 2012 and December 2012 sessions of examinations is 2012-13. Besides all other changes made through Notifications etc. and made effective six months prior to the examination will also be applicable.
(iv)

In the event of any doubt, students may write to the Directorate of Academic and Professional Development in the Institute for clarification.

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

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

This study material is designed in simple and lucid language for the benefit of the students. Students are however advised to consult statutory provisions of the relevant Acts.

This study material has been updated upto 31st August 2011.
EXECUTIVE PROGRAMME

SYLLABUS

FOR

TAX LAWS

Level of knowledge: Working knowledge.

Objective:

(i) To impart knowledge of the basic principles underlying the substantive provisions of Direct and Indirect Tax Laws to the students.

(ii) To equip students with application of principles and provisions of direct tax laws in computation of income and taxation of a ‘person excluding companies under various heads of income and their assessment procedures.

Detailed contents:

PART A - (60 marks)

THE INCOME-TAX ACT

The Income-tax Act

1. Definitions, concept of income, previous year, assessment year, residential status.

2. Distinction between capital and revenue receipts and expenditure.

3. Basis of charge and scope of total income (Incomes deemed to accrue or arise in India and deemed to be received in India).

4. Incomes which do not form part of total income.

5. Computation of total income under various heads, such as - salaries, income from house property, profit and gains of business or profession, capital gains, income from other sources.

6. Income of other persons included in assessee’s total income; aggregation of income and set off or carry forward of losses; various deductions to be made in computing total income, rebates and relief’s; applicable rates of taxes and tax liability.

7. Taxation of every person excluding companies, viz., individuals including non-residents, Hindu Undivided Family, firms, association of persons, cooperative societies, trusts and charitable and religious institutions, etc.


9. Tax deducted at source, collection, recovery and refund of tax; provisions of advance tax.
10. Wealth Tax

Charge of wealth tax; assets, deemed assets and assets exempt from tax; valuation of assets; computation of net wealth, return of wealth and provisions concerning assessment.

PART B – (20 marks)

SERVICE TAX

11. Background, Statutory provisions, taxable services, valuation, administrative mechanism and procedural aspects, rate and computation of tax.

12. Assessment, levy, collection and payment of service tax, exemptions, CENVAT Credit for service tax, returns, appeals, revisions, advance rulings, role of Practising Company Secretaries.

PART C – (20 marks)

VALUE ADDED TAX

13. Legislative background, concept of VAT - white paper on VAT, Report of Empowered Committee of State Finance Ministers, constitutional provisions, relationship of VAT with inter-state commerce and works contract tax, liability under VAT; withdrawal of Central Sales Tax; Goods and Service Tax;

14. Computation, procedural aspects including registration, filling of returns, rates of tax, assessment, credit and set-off, returns, refunds, audit, appeals, revision and appearances.

15. Appointment, jurisdiction and powers of authorities, certifications for professionals.

16. Concept of VAT on services, VAT in other countries, scope for Company Secretaries.
recommended list of books and journals

TAX LAWS

Books for Readings:

I. Direct Taxes:

4. Dr. H.C. Mehrotra and Dr. S.P. Goyal : Direct Taxes (with tax planning); Sahitya Bhawan, Agra.

II. Indirect Taxes:

2. V. Balachandran : Indirect Taxes; Sultan Chand & Sons, New Delhi.
Books for References:

2. S.D. Singh : The Law of Central Sales-tax; Eastern Book Co., Lucknow; Part II.

Journals:

3. Income Tax Reports : Company Law Institute of India Pvt. Ltd., Tyagaraja Road, Madras.
4. Taxmann : Taxmann; 59/32, New Rohtak Road, New Delhi - 110 005.
5. Taxation : Taxation; 174 Jor Bagh, New Delhi.

Note:

(i) Students are advised to read the relevant Bare Acts. 'Student Company Secretary' and 'Chartered Secretary' regularly for updating the knowledge.

(ii) The latest editions of all the books relevant for the applicable assessment year referred to above should be read.
<table>
<thead>
<tr>
<th>Study Lesson No.</th>
<th>Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>PART A - DIRECT TAX LAWS</td>
<td></td>
</tr>
<tr>
<td>I.</td>
<td>Introduction and Important Definitions</td>
</tr>
<tr>
<td>II.</td>
<td>Capital and Revenue Receipts</td>
</tr>
<tr>
<td>III.</td>
<td>Basis of Charge and Scope of Total Income</td>
</tr>
<tr>
<td>IV.</td>
<td>Incomes which do not form part of Total Income</td>
</tr>
<tr>
<td>V.</td>
<td>Computation of Total Income under Various Heads</td>
</tr>
<tr>
<td>VI.</td>
<td>Aggregation of Income, Set-off or Carry Forward of Losses and Deductions from Total Income</td>
</tr>
<tr>
<td>VII.</td>
<td>Taxation of Individuals, HUF, Firms, Association of Persons, Cooperative Societies and Non-Residents</td>
</tr>
<tr>
<td>VIII.</td>
<td>Filing of Returns, signatures, e-filings, assessment and re-assessment</td>
</tr>
<tr>
<td>IX.</td>
<td>TDS and other related Tax matter</td>
</tr>
<tr>
<td>X.</td>
<td>The Wealth Tax Act, 1957</td>
</tr>
<tr>
<td>PART B - SERVICE TAX</td>
<td></td>
</tr>
<tr>
<td>XI.</td>
<td>Background, Administrative and Procedural Aspects</td>
</tr>
<tr>
<td>XII.</td>
<td>Levy, Collection and Payment of Service Tax along with CENVAT Credit Rules</td>
</tr>
<tr>
<td>PART C - VALUE ADDED TAX</td>
<td></td>
</tr>
<tr>
<td>XIII.</td>
<td>Value Added Tax (VAT) – An Overview</td>
</tr>
<tr>
<td>XIV.</td>
<td>Computation and Other Procedural Aspects Relating to VAT</td>
</tr>
<tr>
<td>XV.</td>
<td>Appointment, Jurisdiction and Powers Authorities and the Certifications for Professionals</td>
</tr>
<tr>
<td>XVI.</td>
<td>Concept of VAT Services, VAT in other Countries and Scope for Company Secretaries</td>
</tr>
</tbody>
</table>

TEST PAPERS 2012
EXECUTIVE PROGRAMME
TAX LAWS
DETAILED - CONTENTS
PART A - DIRECT TAX LAWS
STUDY I
INTRODUCTION AND IMPORTANT DEFINITIONS

<table>
<thead>
<tr>
<th>Learning Objectives</th>
<th>...</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Concept of Income tax</td>
<td>...</td>
<td>1</td>
</tr>
<tr>
<td>1.2 Definitions</td>
<td>...</td>
<td>3</td>
</tr>
<tr>
<td>1.2.1 Income [Section 2(24)]</td>
<td>...</td>
<td>3</td>
</tr>
<tr>
<td>1.2.2 Person [Section 2(31)]</td>
<td>...</td>
<td>8</td>
</tr>
<tr>
<td>1.2.3 Assessee</td>
<td>...</td>
<td>10</td>
</tr>
<tr>
<td>1.2.4 Assessment year [Section 2(9)]</td>
<td>...</td>
<td>11</td>
</tr>
<tr>
<td>1.2.5 Previous year (Section 3)</td>
<td>...</td>
<td>11</td>
</tr>
<tr>
<td>1.3 Residence and Tax Liability (Section 6)</td>
<td>...</td>
<td>12</td>
</tr>
<tr>
<td>1.3.1 Test for Residence of individuals</td>
<td>...</td>
<td>12</td>
</tr>
<tr>
<td>1.3.2 Test of Residence for Hindu Undivided Families, Firms and other associations of persons</td>
<td>...</td>
<td>14</td>
</tr>
<tr>
<td>1.3.3 Test of Residence for Companies</td>
<td>...</td>
<td>17</td>
</tr>
<tr>
<td>1.4 Computation of taxable income and Tax liability of an assessee</td>
<td>...</td>
<td>19</td>
</tr>
<tr>
<td>1.5 Tax Rates</td>
<td>...</td>
<td>21</td>
</tr>
<tr>
<td>Lesson Round Up</td>
<td>...</td>
<td>22</td>
</tr>
<tr>
<td>SELF-TEST QUESTIONS</td>
<td>...</td>
<td>22</td>
</tr>
</tbody>
</table>

STUDY II
CAPITAL AND REVENUE RECEIPTS

<table>
<thead>
<tr>
<th>Learning Objectives</th>
<th>...</th>
<th>24</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1 Capital and Revenue Receipts (Conceptual Analysis)</td>
<td>...</td>
<td>24</td>
</tr>
<tr>
<td>2.2 Capital and Revenue Receipts in relation to business activities</td>
<td>...</td>
<td>25</td>
</tr>
<tr>
<td>Lesson Round Up</td>
<td>...</td>
<td>31</td>
</tr>
<tr>
<td>SELF-TEST QUESTIONS</td>
<td>...</td>
<td>32</td>
</tr>
</tbody>
</table>

STUDY III
BASIS OF CHARGE AND SCOPE OF TOTAL INCOME

<table>
<thead>
<tr>
<th>Learning Objectives</th>
<th>...</th>
<th>33</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1 Charge of Income-tax (Section 4)</td>
<td>...</td>
<td>33</td>
</tr>
<tr>
<td>3.1.1 Exceptions</td>
<td>...</td>
<td>33</td>
</tr>
<tr>
<td>— Shipping business of non-resident (Section 172)</td>
<td>...</td>
<td>34</td>
</tr>
<tr>
<td>— Assessment of persons leaving India (Section 174)</td>
<td>...</td>
<td>34</td>
</tr>
<tr>
<td>Page</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>34</td>
<td></td>
<td></td>
</tr>
<tr>
<td>35</td>
<td></td>
<td></td>
</tr>
<tr>
<td>35</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36</td>
<td></td>
<td></td>
</tr>
<tr>
<td>45</td>
<td></td>
<td></td>
</tr>
<tr>
<td>45</td>
<td></td>
<td></td>
</tr>
<tr>
<td>50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>51</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

**STUDY IV**

**INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME**

<table>
<thead>
<tr>
<th>Learning Objectives</th>
<th>52</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 10</td>
<td>55</td>
</tr>
<tr>
<td>Agricultural Income [Section 10(1)]</td>
<td>56</td>
</tr>
<tr>
<td>Money Received by an individual as a Member of H.U.F. [Section 10(2)]</td>
<td>56</td>
</tr>
<tr>
<td>Share of profit from partnership firm [Section 10(2A)]</td>
<td>56</td>
</tr>
<tr>
<td>Interest Income of Non-residents [Section 10(4)]</td>
<td>56</td>
</tr>
<tr>
<td>Interest Income of Non-residents from Specified Savings Certificates [Section 10(4B)]</td>
<td>57</td>
</tr>
<tr>
<td>Travel Concession or Assistance to a Citizen of India [Section 10(5)]</td>
<td>57</td>
</tr>
<tr>
<td>Exemptions to an Individual who is not a Citizen of India [Section 10(6)]</td>
<td>58</td>
</tr>
<tr>
<td>Tax paid on behalf of Foreign Companies in respect of certain Income [Section 10(6A)]</td>
<td>59</td>
</tr>
<tr>
<td>Income derived by a Foreign Company [Section 10(6B)]</td>
<td>60</td>
</tr>
<tr>
<td>Income of foreign aircraft business from lease [Section 10(6BB)]</td>
<td>60</td>
</tr>
<tr>
<td>Fees for technical services received by Foreign Companies [Section 10(6C)]</td>
<td>60</td>
</tr>
<tr>
<td>Allowance Payable outside India [Section 10(7)]</td>
<td>60</td>
</tr>
<tr>
<td>Co-operative Technical Assistance Programmes [Section 10(8)]</td>
<td>60</td>
</tr>
<tr>
<td>Fee received by certain consultants out of funds made available to international organisation [Section 10(8A)]</td>
<td>61</td>
</tr>
<tr>
<td>Remuneration received by certain individual in connection with any technical assistance programme [Section 10(8B)]</td>
<td>61</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
</tr>
<tr>
<td>---------</td>
<td>-------------</td>
</tr>
<tr>
<td>4.17</td>
<td>Income of any Member of the Family [Section 10(9)]</td>
</tr>
<tr>
<td>4.18</td>
<td>Death-cum-Retirement Gratuity [Section 10(10)]</td>
</tr>
<tr>
<td>4.19</td>
<td>Commutation of Pension [Section 10(10A)]</td>
</tr>
<tr>
<td>4.20</td>
<td>Encashment of Earned Leave [Section 10(10AA)]</td>
</tr>
<tr>
<td>4.21</td>
<td>Retrenchment Compensation [Section 10(10B)]</td>
</tr>
<tr>
<td>4.22</td>
<td>Compensation Received by victims of Bhopal Gas Leak Disaster [Section 10(10BB)]</td>
</tr>
<tr>
<td>4.23</td>
<td>Payment received on Voluntary Retirement [Section 10(10C)]</td>
</tr>
<tr>
<td>4.24</td>
<td>Tax paid by the employer on non monetary perquisites [Section 10(CC)]</td>
</tr>
<tr>
<td>4.25</td>
<td>Payment received under a Life Insurance Policy [Section 10(10D)]</td>
</tr>
<tr>
<td>4.26</td>
<td>Payment from Statutory Provident Fund [Section 10(11)]</td>
</tr>
<tr>
<td>4.27</td>
<td>Payment from a Recognised Provident Fund [Section 10(12)]</td>
</tr>
<tr>
<td>4.28</td>
<td>Payment from an Approved Superannuation Fund [Section 10(13)]</td>
</tr>
<tr>
<td>4.29</td>
<td>House Rent Allowance [Section 10(13A)]</td>
</tr>
<tr>
<td>4.30</td>
<td>Special Allowance [Section 10(14)]</td>
</tr>
<tr>
<td>4.31</td>
<td>Interest from certain Investments [Section 10(15)]</td>
</tr>
<tr>
<td>4.32</td>
<td>Lease rent for leasing of an aircraft [Section 10(15A)]</td>
</tr>
<tr>
<td>4.33</td>
<td>Scholarships [Section 10(16)]</td>
</tr>
<tr>
<td>4.34</td>
<td>Daily Allowances of MPs and MLA’s [Section 10(17)]</td>
</tr>
<tr>
<td>4.35</td>
<td>Awards/Rewards [Section 10(17A)]</td>
</tr>
<tr>
<td>4.36</td>
<td>Pension [Section 10(18)]</td>
</tr>
<tr>
<td>4.37</td>
<td>Family Pension [Section 10(19)]</td>
</tr>
<tr>
<td>4.38</td>
<td>Annual Value of Palace of a Ruler [Section 10(19A)]</td>
</tr>
<tr>
<td>4.39</td>
<td>Income of Local Authorities [Section 10(20)]</td>
</tr>
<tr>
<td>4.40</td>
<td>Income of Scientific Research Associations[Section 10(21)]</td>
</tr>
<tr>
<td>4.41</td>
<td>Income of News Agency [Section 10(22B)]</td>
</tr>
<tr>
<td>4.42</td>
<td>Income of a Professional Institution [Section 10(23A)]</td>
</tr>
<tr>
<td>4.43</td>
<td>Income of a Regimental Fund or Non-Public Fund [Section 10(23AA)]</td>
</tr>
<tr>
<td>4.44</td>
<td>Exemption to fund established for welfare of employees (Section 23AAA)</td>
</tr>
<tr>
<td>4.45</td>
<td>Pension fund of LIC [Section 10(23AAB)]</td>
</tr>
<tr>
<td>4.46</td>
<td>Income of an Institution established for promoting Khadi and Village Industries [Section 10(23B)]</td>
</tr>
<tr>
<td>4.47</td>
<td>Income of Khadi and Village Industries Board established by a State Act [Section 10(23BB)]</td>
</tr>
<tr>
<td>4.48</td>
<td>Income of Statutory Authority Administering Charitable Trust etc. [Section 10(23BBA)]</td>
</tr>
<tr>
<td>4.49</td>
<td>Income of European Economic Community [Section 10(23BBB)]</td>
</tr>
<tr>
<td>4.50</td>
<td>Income of SAARC Fund [Section 10(23BBC)]</td>
</tr>
<tr>
<td>4.51</td>
<td>Income of ASOSAI-SECRETARIAT [Section 10(23BBD)]</td>
</tr>
<tr>
<td>4.52</td>
<td>Income of IRDA [Section 10(23BBE)]</td>
</tr>
<tr>
<td>4.53</td>
<td>Any Income Received by any Person on behalf of certain Persons [Section 10(23C)]</td>
</tr>
<tr>
<td>4.54</td>
<td>Income of a Mutual Fund [Section 10(23D)]</td>
</tr>
<tr>
<td>4.55</td>
<td>Income of Investor Protection Fund (Section 23EA)</td>
</tr>
<tr>
<td>4.56</td>
<td>Income of Credit Guarantee Fund Trust for SSI [Section 10(23EB)]</td>
</tr>
<tr>
<td>4.57</td>
<td>Income of Venture Capital Company (Section 23FB)</td>
</tr>
<tr>
<td>4.58</td>
<td>Income of a Registered Trade Union [Section 10(24)]</td>
</tr>
<tr>
<td>4.59</td>
<td>Income to Trustees of certain Funds [Section 10(25)]</td>
</tr>
<tr>
<td>4.60</td>
<td>Exemption to Employees’ State Insurance Fund [Section 10(25A)]</td>
</tr>
<tr>
<td>4.61</td>
<td>Income of a Member of a Scheduled Tribe [Section 10(26)]</td>
</tr>
<tr>
<td>4.62</td>
<td>Income of a Resident of Ladakh [Section 10(26A)]</td>
</tr>
<tr>
<td>4.63</td>
<td>Income of a Corporation Established for Promoting Interest of Scheduled Castes etc. [Section 10(26B)]</td>
</tr>
<tr>
<td>4.64</td>
<td>Exemption to National Minorities Development and Finance Corporation [Section 10(26BB)]</td>
</tr>
<tr>
<td>4.65</td>
<td>Exemption from Income of a Corporation established for the Welfare and Economic Upliftment of Ex-servicemen being Citizens of India</td>
</tr>
<tr>
<td>4.66</td>
<td>Income of Co-operative Societies Promoting the Interest of Members of Scheduled Castes, etc. [Section 10(27)]</td>
</tr>
<tr>
<td>4.67</td>
<td>Exemption of Commodity Boards and Authorities from Income-tax [Section 10(29A)]</td>
</tr>
<tr>
<td>4.68</td>
<td>Subsidy from the Tea Board [Section 10(30)]</td>
</tr>
<tr>
<td>4.69</td>
<td>Subsidy from the Rubber; Coffee; Spices and other Board or authority established under any law and notified by the Central Government [Section 10(31)]</td>
</tr>
<tr>
<td>4.70</td>
<td>Income of minor child [Section 10(32)]</td>
</tr>
<tr>
<td>4.71</td>
<td>Income from transfer of units of UTI [Section 10(33)]</td>
</tr>
<tr>
<td>4.72</td>
<td>Any income by way of dividends referred to in Section 115-O [Section 10(34)]</td>
</tr>
<tr>
<td>4.73</td>
<td>Income from Mutual Funds and certain units[Section 10(35)]</td>
</tr>
<tr>
<td>4.74</td>
<td>Transfer of Specified Equity Shares [Section 10(36)]</td>
</tr>
<tr>
<td>4.75</td>
<td>Income from Transfer of Agricultural Land [Section 10(37)]</td>
</tr>
<tr>
<td>4.76</td>
<td>Income from Transfer of certain equity, units etc. [Section 10(38)]</td>
</tr>
<tr>
<td>4.77</td>
<td>Income from international sporting events [Section 10(39)]</td>
</tr>
<tr>
<td>4.78</td>
<td>Income from subsidiary company [Section 10(40)]</td>
</tr>
<tr>
<td>4.79</td>
<td>Income from transfer of a capital asset [Section 10(41)]</td>
</tr>
<tr>
<td>4.80</td>
<td>Specified income to a body or authority [Section 10(42)]</td>
</tr>
<tr>
<td>4.81</td>
<td>Income to an individual by way of Reverse Mortgage [Section 10(43)]</td>
</tr>
<tr>
<td>4.82</td>
<td>New Pension System Trust [Section 10(44)]</td>
</tr>
<tr>
<td>4.83</td>
<td>Allowance or Perquisite to the chairman of UPSC [Section 10(45)]</td>
</tr>
<tr>
<td>4.84</td>
<td>Income arising to a body, authority or Board or trust or Commission [Section 10(46)]</td>
</tr>
<tr>
<td>4.85</td>
<td>Income of an infrastructure debt fund [Section 10(47)]</td>
</tr>
</tbody>
</table>

**PART II**

| 4.86 | Complete tax holiday for industrial units situated in free trade zones (Section 10A) | 109 |
| 4.86A | Special provision in respect of newly established units in Special economic zone | 114 |
| 4.87 | Special provision in respect of newly established 100% export oriented undertakings (Section 10B) | 118 |
| 4.88 | Meaning of computer programmes in certain cases | 121 |
| 4.89 | Special provision in respect of certain industrial undertakings in North-Eastern region (Section 10C) | 123 |

**PART III**

**TAX EXEMPTIONS FOR CHARITABLE TRUSTS AND INSTITUTIONS**

| 4.90 | Meaning of certain terms | 124 |
| 4.91 | Income not to be included in the Total Income | 126 |
| 4.92 | Capital Gains [Section 11(1A)] | 128 |
| 4.93 | Accumulations of Income [Section 11(2)] | 130 |
| 4.94 | Income from Voluntary Contributions (Section 12) | 133 |
| 4.95 | Income to be included in Total Income [Section 13(1)] | 134 |
| 4.96 | Conditions as to Registration of Trusts, etc. (Section 12A) | 138 |

**PART IV**

| 4.97 | Tax Exemptions to Political Parties (Section 13A) | 140 |
| 4.98 | Voluntary Contributions Received by an Electoral Trust (Section 13B) | 140 |
| | Lesson Round Up | 141 |

**SELF-TEST QUESTIONS**

**STUDY V**

**COMPUTATION OF TOTAL INCOME UNDER VARIOUS HEADS**

**Part I : Income from salary**

| 5.1 | Computation of Income from Salaries | 147 |
| 5.2 | Salary [Section 17(1)] | 152 |
(xvi)

5.3 Allowances … 153
5.3.1 Fully taxable Allowances … 153
5.3.2 Allowances not fully taxable … 154
5.3.3 Treatment of entertainment Allowances … 155
5.4 Perquisites [Section 17(2)] … 155
5.5 Profits in Lieu of or in Addition to Salary … 164
5.6 Deductions Allowed from Salaries (Section 16) … 167
5.7 Provident funds - Treatment of Contributions to and Money Received from the Provident Fund … 167
5.8 Incomes exempt from Tax and not includible in ‘Salary’ — Performa of Computing Taxable Salary … 169
5.9 Illustrations … 170

Part II : Income from House Property

5.10 Basis of Charge … 181
5.11 Determination of Annual Value - u/s 23 … 185
5.12 Computation of Net Annual Value … 187
5.13 Deductions from Income from House Property (Section 24) … 195
5.14 Loss from House Property … 197
5.15 Exemptions … 203

Part III : Income from Business or Profession

5.16 ‘Business’ or ‘Profession’ … 204
5.16.1 Meaning of Business … 204
5.16.2 Meaning of Profession … 205
5.16.3 Continuity of Business or Profession … 205
5.17 Income Chargeable To Income-Tax (Section 28) … 207
5.18 Profits and Losses of Speculation Business … 212
5.19 How Profits and Gains Are Computed … 213
5.20 Deductions Allowable … 216
(A) Rent, Rates, Taxes, Repairs and Insurance for Buildings (Section 30) … 216
(B) Repairs and Insurance of Machinery, Plant and Furniture (Section 31) … 217
(C) Depreciation (Section 32) … 218
(D) Tea/Coffee/Rubber Development Account (Section 33AB) … 243
(E) Site restoration fund [Section 33ABA] … 246
(F) Reserves for Shipping Business (Section 33AC) … 248
(G) Expenditure on Scientific Research (Section 35) … 248
(H) Expenditure on Acquisition of Patent Rights or Copyrights (Section 35A) … 252
(I) Deduction in respect of expenditure on know-how (Section 35AB) … 253
5.21 Expenses Restricted/Disallowed ... 279
5.22 Deemed Profits ... 287
5.23 Special Provision for Deductions in the Case of Business for Prospecting etc. for Mineral Oil (Section 42) ... 290
5.24 Special Provisions Consequential to the Changes in the Rate of Exchange of Currency ... 291
5.25 Special Provision for Computation of Cost of Acquisition of Certain Assets (Section 43C) ... 292
5.26 Special Provision in Case of Income of Public Financial Institutions, etc. (Section 43D) ... 293
5.27 Insurance Business ... 293
5.28 Special Provisions for Deduction in the Case of Trade, Professional or Similar Associations ... 293
5.29 Maintenance of Accounts (Section 44AA) ... 294
5.30 Compulsory Audit of Accounts of Certain Persons Carrying on Business or Profession ... 295
5.31 Special Provision for Computing Profits and Gains of Business on Presumptive Basis (Section 44AD) ... 296
5.32 Special Provisions for Computing Profits and Gains of Business of Plying, Hiring or Leasing Goods Carriages (Section 44AE) ... 297
5.33 Special Provisions for Computing Profits and Gains of Shipping Business in The Case of Non-Resident (Section 44B) ... 298

(xvii)

| (J) | Expenditure on telecom licence (Section 35ABB) | ... 254 |
| (K) | Expenditure on Eligible projects or schemes (Section 35AC) | ... 255 |
| (L) | Expenditure of capital nature in respect of specified business (Section 35AD) | ... 255 |
| (M) | Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes (Section 35CCA) | ... 259 |
| (N) | Expenditure by way of Payment to Associations and Institutions for carrying out Programmes of Conservation of Natural Resources (Section 35CCB) | ... 259 |
| (O) | Amortisation of Preliminary Expenses (Section 35D) | ... 259 |
| (P) | Amortisation of Expenditure in the case of Amalgamation/Demerger (Section 35DD) | ... 262 |
| (Q) | Amortization of Expenditure in the case of Voluntary Retirement Scheme (Section 35DDA) | ... 262 |
| (R) | Deduction in respect of Expenditure on Prospecting etc. for certain Minerals (Section 35E) | ... 262 |
| (S) | Other Deductions | ... 264 |
| (T) | Other Expenses not covered by the Previous Deductions | ... 274 |
### Part IV: Income from Capital Gains

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.39</td>
<td>Capital Gains</td>
<td>307</td>
</tr>
<tr>
<td>5.40</td>
<td>Capital Asset</td>
<td>308</td>
</tr>
<tr>
<td>5.41</td>
<td>Transfer</td>
<td>310</td>
</tr>
<tr>
<td>5.42</td>
<td>Transfer in the previous year</td>
<td>316</td>
</tr>
<tr>
<td>5.43</td>
<td>Gain on Transfer</td>
<td>316</td>
</tr>
<tr>
<td>5.44</td>
<td>Distribution of assets by companies in liquidation (Section 46)</td>
<td>316</td>
</tr>
<tr>
<td>5.45</td>
<td>Short-term and long-term capital gains</td>
<td>317</td>
</tr>
<tr>
<td>5.46</td>
<td>Zero Coupon Bonds</td>
<td>318</td>
</tr>
<tr>
<td>5.47</td>
<td>Mode of computation and deductions</td>
<td>319</td>
</tr>
<tr>
<td>5.48</td>
<td>Costs with reference to certain modes of acquisition</td>
<td>324</td>
</tr>
<tr>
<td>5.49</td>
<td>Meaning of cost of acquisition [Section 55(2)]</td>
<td>325</td>
</tr>
<tr>
<td>5.50</td>
<td>Advance money received</td>
<td>327</td>
</tr>
<tr>
<td>5.51</td>
<td>Cost of improvement</td>
<td>328</td>
</tr>
<tr>
<td>5.52</td>
<td>Capital Gains in case of damage or destruction of Capital Asset</td>
<td>328</td>
</tr>
<tr>
<td>5.53</td>
<td>Transfer of Securities held with Depository [Section 45(2A)]</td>
<td>328</td>
</tr>
<tr>
<td>5.54</td>
<td>Computation of Capital Gains on purchase by company of its own shares or other specified securities</td>
<td>329</td>
</tr>
<tr>
<td>5.55</td>
<td>Capital gains exempt from tax</td>
<td>329</td>
</tr>
<tr>
<td>5.55.1</td>
<td>Profit on sale of property used for residence (Section 54)</td>
<td>329</td>
</tr>
<tr>
<td>5.55.2</td>
<td>Transfer of land used for agricultural purposes (Section 54B)</td>
<td>331</td>
</tr>
<tr>
<td>5.55.3</td>
<td>Compulsory acquisition of lands and buildings (Section 54D)</td>
<td>332</td>
</tr>
<tr>
<td>5.55.4</td>
<td>No tax on long-term capital gains if investments made in specified bonds (Section 54EC)</td>
<td>333</td>
</tr>
<tr>
<td>5.55.5</td>
<td>Capital gains on transfer of certain listed securities or unit, not to be charged in certain cases (Section 54ED)</td>
<td>334</td>
</tr>
<tr>
<td>Section</td>
<td>Page</td>
<td></td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
<td>------</td>
<td></td>
</tr>
<tr>
<td>5.55.6 Capital gain on the transfer of certain capital assets not to be charged in case of investment in residential house (Section 54F)</td>
<td>334</td>
<td></td>
</tr>
<tr>
<td>5.55.7 Capital gain on shifting of industrial undertaking from urban area (Section 54G)</td>
<td>335</td>
<td></td>
</tr>
<tr>
<td>5.55.8 Exemption of capital gain on transfer of assets of shifting of individual undertaking from urban area to a Special Economic Zone [Section 54GA]</td>
<td>337</td>
<td></td>
</tr>
<tr>
<td>5.55.9 Extension of time for acquiring new asset or depositing or investing amount of capital gain (Section 54H)</td>
<td>338</td>
<td></td>
</tr>
<tr>
<td>5.56 Bonus shares and capital gains</td>
<td>338</td>
<td></td>
</tr>
<tr>
<td>5.57 Computation of capital gains in respect of depreciable assets (Section 50)</td>
<td>338</td>
<td></td>
</tr>
<tr>
<td>5.58 Cost of acquisition and capital gain in case of depreciable assets of electricity companies [Section 50A]</td>
<td>339</td>
<td></td>
</tr>
<tr>
<td>5.59 Special provisions for computation of capital gains in case of slump sale [Section 50B]</td>
<td>339</td>
<td></td>
</tr>
<tr>
<td>5.60 Computation of capital gain in real estate transaction [Section 50C]</td>
<td>339</td>
<td></td>
</tr>
<tr>
<td>5.61 Reference to Valuation Officer (Section 55A)</td>
<td>340</td>
<td></td>
</tr>
</tbody>
</table>

**Part V : Income from other sources**

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.62 Income chargeable under the head ‘Income from other Sources’</td>
<td>341</td>
</tr>
<tr>
<td>5.63 Taxation of Dividends</td>
<td>346</td>
</tr>
<tr>
<td>5.64 Deductions allowable in computing income from other sources</td>
<td>351</td>
</tr>
<tr>
<td>5.65 Amounts not Deductible (Section 58)</td>
<td>353</td>
</tr>
<tr>
<td>5.66 Tax Concessions</td>
<td>354</td>
</tr>
<tr>
<td>Lesson Round Up</td>
<td>358</td>
</tr>
</tbody>
</table>

**STUDY VI**

**AGGREGATION OF INCOME, SET-OFF OR CARRY FORWARD OF LOSSES AND DEDUCTIONS FROM TOTAL INCOME**

**PART I**

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Learning Objectives</td>
<td>361</td>
</tr>
<tr>
<td>6.1 Aggregation of Income</td>
<td>364</td>
</tr>
<tr>
<td>6.2 Transfer of Income (Section 60)</td>
<td>364</td>
</tr>
<tr>
<td>6.3 Revocable Transfer of Assets (Section 61)</td>
<td>364</td>
</tr>
<tr>
<td>6.4 Transfer irrevocable for a specified period (Section 62)</td>
<td>365</td>
</tr>
<tr>
<td>6.5 Income of Spouse</td>
<td>366</td>
</tr>
<tr>
<td>6.6 Income to son’s wife [Section 64(1)(vi)]</td>
<td>367</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
</tr>
<tr>
<td>---------</td>
<td>-------------</td>
</tr>
<tr>
<td>6.7</td>
<td>Transfer for immediate or deferred benefit of Son's Wife [Section 64(1)(viii)]</td>
</tr>
<tr>
<td>6.8</td>
<td>Income to Spouse through a Third Person [Section 64(1)(vii)]</td>
</tr>
<tr>
<td>6.9</td>
<td>Clubbing of income of minor child [Section 64(1A)]</td>
</tr>
<tr>
<td>6.10</td>
<td>Income from the converted property [Section 64(2)]</td>
</tr>
<tr>
<td>6.11</td>
<td>Recovery of Tax</td>
</tr>
<tr>
<td>6.12</td>
<td>Certain Amounts Deemed as Income</td>
</tr>
<tr>
<td>6.12a</td>
<td>Cash Credits (Section 68)</td>
</tr>
<tr>
<td>6.12b</td>
<td>Unexplained Investment (Section 69)</td>
</tr>
<tr>
<td>6.12c</td>
<td>Unexplained Money etc. (Section 69A)</td>
</tr>
<tr>
<td>6.12d</td>
<td>Under Valued Investments or Valuables (Section 69B)</td>
</tr>
<tr>
<td>6.12e</td>
<td>Unexplained Expenditure (Section 69C)</td>
</tr>
<tr>
<td>6.12f</td>
<td>Amount borrowed or repaid on Hundi (Section 69D)</td>
</tr>
</tbody>
</table>

**PART II**

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.13</td>
<td>Set-off and Carry-forward of Losses</td>
<td>372</td>
</tr>
<tr>
<td>6.14</td>
<td>Set-off of losses from one source against income from another source under the same head of income [Section 70]</td>
<td>372</td>
</tr>
<tr>
<td>6.15</td>
<td>Carry-forward and set-off of losses</td>
<td>374</td>
</tr>
<tr>
<td>6.16</td>
<td>Carry forward and set-off of accumulated business loss and unabsorbed depreciation in certain cases of amalgamation or demerger etc. (Section 72A)</td>
<td>376</td>
</tr>
<tr>
<td>6.17</td>
<td>Carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation of banking company in certain cases (Section 72AA)</td>
<td>381</td>
</tr>
<tr>
<td>6.18</td>
<td>Treatment of carry-forward of losses of certain assessees</td>
<td>381</td>
</tr>
</tbody>
</table>

**PART III**

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.19</td>
<td>Deduction on life insurance premia, contribution to provident fund, etc. (Section 80C) (w.e.f. A.Y. 2006-07)</td>
<td>383</td>
</tr>
<tr>
<td>6.20</td>
<td>Deduction for contribution to pension fund (Section 80CCC)</td>
<td>387</td>
</tr>
<tr>
<td>6.21</td>
<td>Deduction in respect of contribution to pension scheme of Central Government [Section 80CCD]</td>
<td>387</td>
</tr>
<tr>
<td>6.22</td>
<td>Limit on deductions under Sections 80C, 80CCC and 80CCD (Section 80CCE)</td>
<td>388</td>
</tr>
<tr>
<td>6.23</td>
<td>Reduction in respect of subscription to long-term Infrastructure Bonds (Section 80CCF)</td>
<td>388</td>
</tr>
<tr>
<td>6.24</td>
<td>Deduction in respect of medical insurance premia (Section 80D)</td>
<td>388</td>
</tr>
<tr>
<td>6.25</td>
<td>Deduction in respect of maintenance including medical treatment of a dependant who is a person with disability [Section 80DD]</td>
<td>389</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
<td>Page</td>
</tr>
<tr>
<td>---------</td>
<td>-----------------------------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>6.26</td>
<td>Deduction in respect of medical treatment, etc. (Section 80DDB read with Rule 11DD)</td>
<td>391</td>
</tr>
<tr>
<td>6.27</td>
<td>Deduction in respect of repayment of loan taken for higher education (Section 80E)</td>
<td>392</td>
</tr>
<tr>
<td>6.28</td>
<td>Deduction in respect of donations to certain funds, charitable institutions, etc. (Section 80G)</td>
<td>392</td>
</tr>
<tr>
<td>6.29</td>
<td>Deduction in respect of rent paid (Section 80GG)</td>
<td>396</td>
</tr>
<tr>
<td>6.30</td>
<td>Deduction in respect of certain donations for scientific research or rural development (Section 80GGA)</td>
<td>396</td>
</tr>
<tr>
<td>6.31</td>
<td>Deduction in respect of contributions given by companies to political parties or an electoral trust (Section 80GGB)</td>
<td>397</td>
</tr>
<tr>
<td>6.32</td>
<td>Deduction in respect of contributions given by any person to political parties or an electoral trust (Section 80GGC)</td>
<td>398</td>
</tr>
<tr>
<td>6.33</td>
<td>Deduction in respect of profits and gains from industrial undertakings or enterprise engaged in infrastructure development (Section 80-IA)</td>
<td>398</td>
</tr>
<tr>
<td>6.34</td>
<td>Deduction in respect of profit and gains by an undertaking an enterprise engaged in development of Special Economic Zone [Section 80-IAB]</td>
<td>401</td>
</tr>
<tr>
<td>6.35</td>
<td>Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings [Section 80-IB]</td>
<td>402</td>
</tr>
<tr>
<td>6.36</td>
<td>Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC]</td>
<td>410</td>
</tr>
<tr>
<td>6.37</td>
<td>Deduction in respect of profits and gains from the business of collecting and processing bio-degradable waste (Section 80-JJA)</td>
<td>412</td>
</tr>
<tr>
<td>6.38</td>
<td>Deduction in respect of employment of new workmen (Section 80-JJAA)</td>
<td>413</td>
</tr>
<tr>
<td>6.39</td>
<td>Deduction in respect of certain incomes of Offshore Banking Units (Section 80LA)</td>
<td>413</td>
</tr>
<tr>
<td>6.40</td>
<td>Deduction in respect of income of co-operative societies (Section 80P)</td>
<td>414</td>
</tr>
<tr>
<td>6.41</td>
<td>Deduction in respect of royalty income, etc., of authors of certain books other than text books (Section 80QQB)</td>
<td>416</td>
</tr>
<tr>
<td>6.42</td>
<td>Deduction in respect of royalty on patents (Section 80RRB)</td>
<td>416</td>
</tr>
<tr>
<td>6.43</td>
<td>Deduction in case of a person with disability (Section 80U)</td>
<td>418</td>
</tr>
<tr>
<td>6.44</td>
<td>Relief and Rebate in respect of Income-tax and Rates of Income-tax</td>
<td>419</td>
</tr>
<tr>
<td>6.45</td>
<td>Share of member of an association of persons or body of individuals in the income of the association or body (Section 86)</td>
<td>419</td>
</tr>
<tr>
<td>6.46</td>
<td>Income from an association of persons or a body of individuals (Section 86)</td>
<td>420</td>
</tr>
</tbody>
</table>
STUDY VII
TAXATION OF INDIVIDUALS, HUF, FIRMS, ASSOCIATION OF PERSONS,
COOPERATIVE SOCIETIES AND NON-RESIDENTS

Learning Objectives ... 423
7.1 Taxation of Individuals ... 424
7.2 Taxation of Hindu Undivided Families ... 425
7.2.1 Computation of Income of the H.U.F. ... 429
7.2.2 Partition of a Hindu undivided family (Section 171) ... 431
7.3 Taxation of Firms ... 433
(1) New Scheme of taxation of a firm and its partners ... 434
(2) Change in Constitution of a Firm (Section 187) ... 435
(3) Losses of Registered Firms (Section 75) ... 435
(4) Assessment of Partners ... 436
(5) Succession of one firm by another firm (Section 188) ... 436
(6) Special provisions relating to Retail Trade
   [Merged with Section 44AD from AY 11-12] ... 438
(7) Alternate Minimum Tax (AMT) (Section 11SJC) ... 438
(8) Illustration ... 438
7.4 Taxation of Association of Persons ... 441
(1) Meaning ... 441
(2) Formation of an Association of Persons ... 442
(3) Tax Liability of an Association of Persons ... 443
(4) Method of Computing Share of a Member of Association of Persons, etc. (Section 67A) ... 444
(5) Assessment in case of Dissolution of an Association of Persons (Section 177) ... 446
7.5 Taxation of Co-Operative Societies ... 446
(1) Meaning [Section 2(10)] ... 446
(2) Computation of Income of Co-operative Societies ... 447
(3) Assessment of Co-operative Societies ... 449
(4) Rates of Income-tax ... 453
(5) Illustrations ... 454
(6) Tonnage Tax Scheme [Sections 115V to 115VZC]
   (w.e.f. Assessment Year 2005-06) ... 455
7.6 Taxation of Non-Residents ... 455
(1) Introduction ... 455
(2) Exemptions and Concessions to Non-residents ... 456
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.7</td>
<td>Tax on income from Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer</td>
<td>463</td>
</tr>
<tr>
<td>7.8</td>
<td>Profits of non-residents from Occasional Shipping Business (Section 172)</td>
<td>466</td>
</tr>
<tr>
<td>7.9</td>
<td>Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents (Section 44BBA)</td>
<td>467</td>
</tr>
<tr>
<td>7.10</td>
<td>Determination of Income in certain cases (Rule 10)</td>
<td>468</td>
</tr>
<tr>
<td>7.11</td>
<td>Mode of Assessment</td>
<td>469</td>
</tr>
<tr>
<td>7.12</td>
<td>Recovery of Tax</td>
<td>470</td>
</tr>
<tr>
<td>7.13</td>
<td>Agriculture Income</td>
<td>471</td>
</tr>
<tr>
<td>7.14</td>
<td>Determination of Tax liability</td>
<td>478</td>
</tr>
<tr>
<td></td>
<td>Lesson Round Up</td>
<td>481</td>
</tr>
<tr>
<td></td>
<td>SELF-TEST QUESTIONS</td>
<td>482</td>
</tr>
<tr>
<td></td>
<td>STUDY VIII</td>
<td></td>
</tr>
<tr>
<td>8.1</td>
<td>Income-Tax Authorities (Appointment, Jurisdiction and Powers) (Section 116)</td>
<td>485</td>
</tr>
<tr>
<td>8.2</td>
<td>Appointment of Income-tax Authorities (Section 117)</td>
<td>486</td>
</tr>
<tr>
<td>8.3</td>
<td>Control of Income-tax Authorities (Section 118)</td>
<td>486</td>
</tr>
<tr>
<td>8.4</td>
<td>The Central Board of Direct Taxes</td>
<td>486</td>
</tr>
<tr>
<td>8.5</td>
<td>Appointment and Working of the Board</td>
<td>486</td>
</tr>
<tr>
<td>8.6</td>
<td>Jurisdiction</td>
<td>486</td>
</tr>
<tr>
<td>8.7</td>
<td>Power</td>
<td>487</td>
</tr>
<tr>
<td>8.8</td>
<td>Jurisdiction of Income-tax Authorities (Section 120)</td>
<td>487</td>
</tr>
<tr>
<td>8.9</td>
<td>Director-General or Director of Income-tax</td>
<td>488</td>
</tr>
<tr>
<td>8.10</td>
<td>Chief Commissioner or Commissioner of Income-tax</td>
<td>489</td>
</tr>
<tr>
<td>8.11</td>
<td>Commissioner of Income-tax (Appeals)</td>
<td>491</td>
</tr>
<tr>
<td>8.12</td>
<td>Return of Income [Section 139(ii)]</td>
<td>493</td>
</tr>
<tr>
<td>8.13</td>
<td>Due date for filing return of Income</td>
<td>493</td>
</tr>
<tr>
<td>8.14</td>
<td>E-filing of Return</td>
<td>494</td>
</tr>
<tr>
<td>8.15</td>
<td>Bulk filing of Return</td>
<td>494</td>
</tr>
<tr>
<td>8.16</td>
<td>Power to Central Government</td>
<td>494</td>
</tr>
<tr>
<td>8.17</td>
<td>Return of Loss</td>
<td>495</td>
</tr>
<tr>
<td>8.18</td>
<td>Belated Return</td>
<td>495</td>
</tr>
<tr>
<td>8.19</td>
<td>Return of Income of Charitable trust and Institution</td>
<td>495</td>
</tr>
<tr>
<td>8.20</td>
<td>Return of Income of Political Party</td>
<td>496</td>
</tr>
<tr>
<td>8.21</td>
<td>Return of Income of Specified Association/Institutions</td>
<td>496</td>
</tr>
<tr>
<td>Page</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.22 Revised Return</td>
<td>496</td>
<td></td>
</tr>
<tr>
<td>8.23 Defective Return</td>
<td>496</td>
<td></td>
</tr>
<tr>
<td>8.24 New scheme to facilitate submission of returns through Tax return preparers [Section 139B]</td>
<td>498</td>
<td></td>
</tr>
<tr>
<td>8.25 Signing of Return</td>
<td>499</td>
<td></td>
</tr>
<tr>
<td>8.26 Permanent Account Number</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>8.27 Quoting of PAN</td>
<td>501</td>
<td></td>
</tr>
<tr>
<td>8.28 Types of Assessment</td>
<td>502</td>
<td></td>
</tr>
<tr>
<td>8.29 Reference of Dispute Resolution Panel (Section 144C)</td>
<td>508</td>
<td></td>
</tr>
<tr>
<td>8.30 Rectification of Mistakes [Section 154]</td>
<td>509</td>
<td></td>
</tr>
<tr>
<td>Lesson Round Up</td>
<td>510</td>
<td></td>
</tr>
<tr>
<td>SELF-TEST QUESTIONS</td>
<td>510</td>
<td></td>
</tr>
</tbody>
</table>

### STUDY IX

**TDS AND OTHER RELATED TAX MATTER**

**Learning Objectives**

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.1 Collection and Recovery of Tax</td>
</tr>
<tr>
<td>9.2 Payment of Income-Tax</td>
</tr>
<tr>
<td>9.3 Refunds (Sections 237 to 245)</td>
</tr>
<tr>
<td>9.4 For failure to deduct and pay tax at source [Section 201]</td>
</tr>
<tr>
<td>9.5 For belated payment of Income-tax [Section 220(2)]</td>
</tr>
<tr>
<td>9.6 Interest for default in furnishing Return of Income (Section 234A)</td>
</tr>
<tr>
<td>9.7 Interest for default in payment of Advance Tax (Section 234B)</td>
</tr>
<tr>
<td>9.8 Interest for deferment of Advance Tax (Section 234C)</td>
</tr>
<tr>
<td>9.9 Interest Receivable by the Assessee</td>
</tr>
<tr>
<td>Lesson Round Up</td>
</tr>
<tr>
<td>SELF-TEST QUESTIONS</td>
</tr>
</tbody>
</table>

### STUDY X

**THE WEALTH TAX ACT, 1957**

**Learning Objectives**

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.1 Charge of Tax</td>
</tr>
<tr>
<td>10.2 Incidence of Wealth-tax</td>
</tr>
<tr>
<td>10.3 Valuation Date [Section 2(q)]</td>
</tr>
<tr>
<td>10.4 Tax Rate</td>
</tr>
<tr>
<td>10.5 Net Wealth [Section 2(m)]</td>
</tr>
<tr>
<td>10.5.1 Assets (Section 2(ea))</td>
</tr>
<tr>
<td>10.5.2 Assets belonging to others but Includible in the Net Wealth of an individual (Deemed Assets) (Section 4)</td>
</tr>
<tr>
<td>10.5.3 Assets exempt from wealth-tax</td>
</tr>
<tr>
<td>Lesson Round Up</td>
</tr>
<tr>
<td>Topic</td>
</tr>
<tr>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>10.5.4 Debts and Liabilities</td>
</tr>
<tr>
<td>10.5.5 Location of Assets and Debts</td>
</tr>
<tr>
<td>10.5.6 Valuation of Assets</td>
</tr>
<tr>
<td>10.5.7 Rounding off Net Wealth</td>
</tr>
<tr>
<td>10.6 Return of Wealth</td>
</tr>
<tr>
<td>(1) Voluntary Return</td>
</tr>
<tr>
<td>(2) Return after Due Date and Amendment of Return (Section 15)</td>
</tr>
<tr>
<td>10.7 Assessment</td>
</tr>
<tr>
<td>(1) Self Assessment [Section 15B]</td>
</tr>
<tr>
<td>(2) Assessment</td>
</tr>
<tr>
<td>(3) Wealth Escaping Assessment (Section 17)</td>
</tr>
<tr>
<td>(4) Time limit for completion of Assessment and Re-assessment</td>
</tr>
<tr>
<td>10.8 Liability to Assessment in Special Cases</td>
</tr>
<tr>
<td>(1) Tax of Deceased Person Payable by Legal Representative (Section 19)</td>
</tr>
<tr>
<td>(2) Assessment in the case of Executors (Section 19A)</td>
</tr>
<tr>
<td>(3) Assessment after Partition of a Hindu Undivided Family (Section 20)</td>
</tr>
<tr>
<td>(4) Assessment after Partial Partition of a Hindu Undivided Family (Section 20A)</td>
</tr>
<tr>
<td>(5) Assessment of Charitable Trusts (Section 21A)</td>
</tr>
<tr>
<td>(6) Assessment of an Association of Persons (Section 21AA)</td>
</tr>
<tr>
<td>(7) Assessment of Persons Residing outside India (Section 22)</td>
</tr>
<tr>
<td>10.9 Payment and Recovery of Wealth-Tax</td>
</tr>
<tr>
<td>(1) Notice of Demand (Section 30)</td>
</tr>
<tr>
<td>(2) Liability of Transferees of Properties (Section 33)</td>
</tr>
<tr>
<td>10.10 Refunds (Section 34A)</td>
</tr>
<tr>
<td>10.11 Rectification of Mistakes (Section 35)</td>
</tr>
<tr>
<td>10.12 Settlement of Cases</td>
</tr>
<tr>
<td>10.13 Appeals, Revisions and References</td>
</tr>
<tr>
<td>(1) Appeal to the Commissioner (Appeals) [Section 23(1)]</td>
</tr>
<tr>
<td>(2) Appeal to Commissioner (Appeals) [Section 23(1A) &amp; (B)]</td>
</tr>
<tr>
<td>(3) Appeal to the Appellate Tribunal (Section 24)</td>
</tr>
<tr>
<td>(4) Revisions of Orders by Commissioner (Section 25)</td>
</tr>
<tr>
<td>(5) Reference to the High Court (Sections 27)</td>
</tr>
<tr>
<td>(6) Appeal to High Court (Section 27A)</td>
</tr>
<tr>
<td>(7) Appeal to Supreme Court (Section 29)</td>
</tr>
</tbody>
</table>
10.14 Penalties under the Wealth-Tax Act
   (1) Penalties Imposable under Wealth-tax Act ... 595
   (2) Failure to Pay Tax (Section 31) ... 600
10.15 Power to Reduce or Waive Penalty (Section 18B) ... 600
10.16 Offences and Prosecutions (Sections 35A to 35N)
   (1) Willful Attempt to Evade Tax etc. (Section 35A) ... 601
   (2) Failure to Furnish Returns of Net Wealth (Section 35B) ... 601
   (3) Failure to Produce Accounts and Documents (Section 35C) ... 602
   (4) False Statement in Verification (Section 35D) ... 602
   (5) False Statement in Verification by Registered Valuers
       (Section 35E) ... 602
   (6) Failure to furnish particulars under Section 34ACC
       (Section 35EE) ... 602
   (7) Contravention of order made under Section 37A
       (Section 35EEE) ... 602
   (8) Abetment of False Return, etc. (Section 35F) ... 602
   (9) Punishment for Second and Subsequent Offences
       (Section 35G) ... 603
   (10) Offences by H.U.F. (Section 35H) ... 603
   (11) Offences by companies (Section 35HA) ... 603
   (12) Prosecutions to be at the instance of Chief Commissioner
        or Commissioner and power of Chief Commissioner to
        compound offences (Section 35-I) ... 603
   (13) Certain offences to be non-cognizable(Section 35J) ... 604
   (14) Bar on Prosecution (Section 35K) ... 604
   (15) Jurisdiction of Courts (Section 35L) ... 604
   (16) Section 360 of the code of Criminal Procedure, 1973 and 629
        the Probation of Offenders Act, 1958 not to apply
        (Section 35M) ... 604
   (17) Immunity from Prosecution (Section 36A) ... 604
Lesson Round Up ... 605

SELF-TEST QUESTIONS ... 605

PART B - SERVICE TAX
STUDY XI
BACKGROUND, ADMINISTRATIVE AND PROCEDURAL ASPECTS

Learning Objectives ... 608
11.1 Background ... 608
<table>
<thead>
<tr>
<th>(xxvii)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.2 Constitution Validity</td>
</tr>
<tr>
<td>11.3 Scope</td>
</tr>
<tr>
<td>11.4 Administrative Mechanism</td>
</tr>
<tr>
<td>11.5 Categories of Services</td>
</tr>
<tr>
<td>11.6 Rate of Service Tax</td>
</tr>
<tr>
<td>11.7 Computation of Tax</td>
</tr>
<tr>
<td>Lesson Round Up</td>
</tr>
<tr>
<td>SELF-TEST QUESTIONS</td>
</tr>
</tbody>
</table>

**STUDY XII**

**LEVY, COLLECTION AND PAYMENT OF SERVICE TAX ALONG WITH CENVAT CREDIT RULES**

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Learning Objectives</td>
</tr>
<tr>
<td>12.1 Payment of Service Tax</td>
</tr>
<tr>
<td>12.2 Reverse Charge</td>
</tr>
<tr>
<td>12.3 Basis of Service Tax and Due Date for Payment of Service Tax</td>
</tr>
<tr>
<td>12.4 Point of Taxation (POT) Rules 2011</td>
</tr>
<tr>
<td>12.5 Registration</td>
</tr>
<tr>
<td>12.5.1 Who Shall Apply?</td>
</tr>
<tr>
<td>12.5.2 Single Registration for Multiple services</td>
</tr>
<tr>
<td>12.5.3 Issue of Registration Certificate</td>
</tr>
<tr>
<td>12.5.4 Surrender of Certificate of Registration</td>
</tr>
<tr>
<td>12.6 Service Tax Registration of Special Category of Persons</td>
</tr>
<tr>
<td>12.7 Exemption</td>
</tr>
<tr>
<td>12.8 Records to be maintained</td>
</tr>
<tr>
<td>12.9 Adjustment of Service Tax</td>
</tr>
<tr>
<td>12.10 Return under Service Tax</td>
</tr>
<tr>
<td>12.10.1 E-filing of Service Tax Returns</td>
</tr>
<tr>
<td>12.10.2 Revision of Returns</td>
</tr>
<tr>
<td>12.10.3 Penalty for late filing of return</td>
</tr>
<tr>
<td>12.11 Recovery of Service Tax</td>
</tr>
<tr>
<td>12.11.1 Recovery of service tax not levied or paid or short levied or short paid or erroneously refunded [Section 73(1)]</td>
</tr>
<tr>
<td>12.12 Provisional attachment pending adjudication</td>
</tr>
<tr>
<td>12.13 Amount collected representing as service tax must be paid to Government</td>
</tr>
<tr>
<td>12.14 Interest on Delayed Payment of Service Tax under Section 75</td>
</tr>
<tr>
<td>12.15 Doctrine of unjust enrichment</td>
</tr>
</tbody>
</table>
### PART C – VALUE ADDED TAX

#### STUDY XIII

**VALUE ADDED TAX (VAT) – AN OVERVIEW**

<table>
<thead>
<tr>
<th>Learning Objectives</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.1 Introduction</td>
<td>637</td>
</tr>
<tr>
<td>13.2 Extracts from Kelkar Committee Report</td>
<td>641</td>
</tr>
<tr>
<td>13.3 VAT liability</td>
<td>642</td>
</tr>
<tr>
<td>13.4 Advantages</td>
<td>643</td>
</tr>
<tr>
<td>13.5 Work Contract Tax</td>
<td>643</td>
</tr>
<tr>
<td>13.6 Withdrawal of Central Sales Taxes</td>
<td>644</td>
</tr>
<tr>
<td>13.7 Goods and Service Tax</td>
<td>644</td>
</tr>
<tr>
<td>Lesson Round Up</td>
<td>645</td>
</tr>
</tbody>
</table>

**SELF-TEST QUESTIONS**

#### STUDY XIV

**COMPUTATION AND OTHER PROCEDURAL ASPECTS RELATING TO VAT**

<table>
<thead>
<tr>
<th>Learning Objectives</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.1 Methods of Computation</td>
<td>646</td>
</tr>
<tr>
<td>14.2 Procedure</td>
<td>647</td>
</tr>
<tr>
<td>14.3 Rates of Tax</td>
<td>647</td>
</tr>
<tr>
<td>14.4 Distinction Between Existing System and VAT</td>
<td>648</td>
</tr>
<tr>
<td>14.5 Registration</td>
<td>649</td>
</tr>
<tr>
<td>14.6 Exempt Sale</td>
<td>650</td>
</tr>
<tr>
<td>14.7 Credit and Set-off under VAT</td>
<td>650</td>
</tr>
<tr>
<td>14.8 Assessment</td>
<td>652</td>
</tr>
</tbody>
</table>
STUDY XV

 appointment, Jurisdiction and powers authorities and the certifications for professionals

15.1 The VAT system
15.2 Some the states in which VAT is implemented
15.3 Andhra Pradesh
15.4 Arunachal Pradesh
15.5 Assam
15.6 Bihar
15.7 Chattisgarh
15.8 Goa
15.9 Gujarat
15.10 Haryana
15.11 Himachal Pradesh
15.12 Karnataka
15.13 Kerala
15.14 Madhya Pradesh
15.15 Maharashtra
15.16 Orissa
15.17 Punjab
15.18 Tamilnadu
15.19 Uttar Pradesh
15.20 West Bengal
15.21 Certification for Professionals

Lesson Round Up

SELF-TEST QUESTIONS

STUDY XVI

VAT in other countries and scope for company secretaries

16.1 VAT in other Countries
   — Australia
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>670</td>
</tr>
<tr>
<td>The European Union</td>
<td>670</td>
</tr>
<tr>
<td>France</td>
<td>671</td>
</tr>
<tr>
<td>Germany</td>
<td>671</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>671</td>
</tr>
<tr>
<td>United States</td>
<td>672</td>
</tr>
<tr>
<td>16.2 Role and Position of Company Secretaries</td>
<td>672</td>
</tr>
<tr>
<td>Lesson Round Up</td>
<td>674</td>
</tr>
<tr>
<td>SELF-TEST QUESTIONS</td>
<td>674</td>
</tr>
<tr>
<td><strong>TEST PAPERS 2012</strong></td>
<td></td>
</tr>
<tr>
<td>Test Paper 1/2012</td>
<td>677</td>
</tr>
<tr>
<td>Test Paper 2/2012</td>
<td>679</td>
</tr>
<tr>
<td>Test Paper 3/2012</td>
<td>680</td>
</tr>
<tr>
<td>Test Paper 4/2012</td>
<td>684</td>
</tr>
<tr>
<td>Test Paper 5/2012</td>
<td>689</td>
</tr>
<tr>
<td><strong>QUESTION PAPERS OF PREVIOUS SESSIONS</strong></td>
<td>693</td>
</tr>
</tbody>
</table>
EXECUTIVE PROGRAMME
TAX LAWS
STUDY I
INTRODUCTION AND IMPORTANT DEFINITIONS

LEARNING OBJECTIVES
The learning objective of this study lesson is to enable the students to understand:
- Concept of Income Tax
- Important Definitions under the Income Tax Act
  - Income [Section 2(24)]
  - Agricultural Income [Section 2(1A)]
  - Person [Section 2(31)]
  - Assessee [Section 2(7)]
  - Assessment
  - Assessment Year [Section 2(9)]
  - Previous Year (Section 3)
  - Company, Indian Company and Principal Officer
- Computation of Taxable Income and Tax liability of an assessee
- Residence and tax liability (Section 6)
  (a) Test of Residence for individuals
  (b) Tests of Residence for Hindu Undivided Families, Firms and other Associations of Persons
- (c) Tests of Residence for Companies
- Tax Rates

1.1 Concept of Income Tax
- Income tax is one of the form of Direct Taxes. Tax is the financial charge imposed by the Government on income, commodity or activity. Government imposes two types of taxes namely Direct taxes and Indirect taxes. Direct tax is one where burden of tax is directly on the payer e.g income tax, wealth tax
etc. Indirect tax is paid by the person other than the person who utilize the product or service e.g Excise duty, Custom duty, Service tax, Sales Tax, Value Added Tax.

- The taxes are collected for serving the primary purpose of providing sufficient revenues to the State, taxes have come to be recognised as an instrument through which the social and economic objectives of a welfare State could be achieved. They are utilized now for providing incentives for larger earnings and more savings, fostering industrial development by selective concessions, restraining ostentatious expenditure, checking inflationary pressures and achieving social objectives like inequalities and the enlargement of opportunities to the common man.

- Income-tax is one of the major sources of revenue for the Government. The responsibility for collection of income-tax vests with the Central Government. This tax is leviable and collected under Income-tax Act, 1961 (hereinafter referred to as the Act).

- The Income-tax Act, in its present form came into force on and from 1st April, 1962. Before this, the Indian Income-tax Act, 1922 was in force. The procedural matters with regard to income-tax are governed by the Income-tax Rules, 1962, its earlier counterpart being the Income-tax Rules, 1922.

- The Income tax Act contains the provisions for determination of taxable income, determination of tax liability, procedure for assessment, appeal, penalties and prosecutions. It also lays down the powers and duties of various income tax authorities.

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

- **Notifications**: The CBDT issue 7notifications from time to time for proper administration of the Income tax Act. Thses notifications become rules and collectively called **Income Tax Rules, 1962**.

- **Circulars**: Circulars also issued by the CBDT to clarify the doubts regarding the scope and meaning of the provisions. These provisions are issued for the guidance of the Income Tax officers and assesseees. These circulars are binding on the department, not on the assesseee but assesseee can take benefit of these circulars.

- **Judicial Decisions**: Decisions pronounced by Supreme Court becomes law and they are binding on all the courts, Appellate Tribunal, Income Tax Authorities and on assessees while High Court decisions are binding on assessees and Income Tax Authorities which come under its jurisdiction unless it is overruled by a higher authority. The decision of a High Court can not bind other High Court.
1.2 Definitions

The definitions of the various terms and phrases used at many places are to be found in Section 2 of the Income-tax Act, 1961. Students are advised to refer to Section 2 for a study of these definitions. Some of the important definitions have been discussed below while the others have been referred-to at appropriate places.

1.2.1 Income [Section 2(24)]

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

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

Definition of Income under Section 2(24) of the Act:

The term income means and includes:

(i) profits and gains;
(ii) dividend;
(iia) voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes or by an association or institution referred to in clause (21) or clause (23) or by a fund or trust or institution referred to in sub-clause (iv) or sub-clause (v) or by any university or other educational institution referred to in sub-clause (vi) or by any hospital or other institution referred to in sub-clause (via) of clause (23C) of Section 10 of the Act;
(iii) the value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of Section 17 of the Act;
(iiiia) any special allowance or benefit, other than perquisite included in the above clause (d), 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 [inserted by the DTLA, 1989, with retrospective effect from 1.4.1962].
(iiiib) 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 [inserted by the DTLA, 1989, with retrospective effect from 1.4.1962];
(iv) 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;

(iva) 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;

(v) any sum chargeable to tax as business income under Section 28(ii), any amount taxable in the hands of a trade, professional or similar association (for specific services performed for its members) as its income from business under Section 28(iii), and deemed profits which are taxable under Sections 41 and 59 of the Act;

(va) any sum chargeable to income-tax under clause (iiia) of Section 28, i.e. profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 [inserted by the Finance Act, 1990, with retrospective effect from 1.4.1962];

(vb) any sum chargeable to income-tax under clause (iiib) of Section 28 i.e., cash assistance (by whatever name called), received or receivable by any person against exports under any scheme of the Government of India [inserted by the Finance Act, 1990, with retrospective effect from 1.4.1967];

(vc) any sum chargeable to income-tax under clause (iiic) of Section 28 i.e., any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971 [inserted by the Finance Act, 1990, with retrospective effect from 1.4.1972];

(vd) the value of any benefit or perquisite whether convertible into money or not; taxable as income under Section 28(iv) in the case of person carrying on business or exercising a profession;

(ve) any sum chargeable to income-tax under clause (v) of Section 28;

(vi) 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. 

Addl. CIT v. Uma Devi Budhia (1986) 157 ITR 478 (Pat.) / CIT v. M.A. Alagappan (1977) 109 ITR 1000 (Mad);

(vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society computed in accordance with 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;

(viia) the profits and gains of any business of banking (including) providing credit facilities carried on by a cooperative society with its members.

(viii) Omitted by Finance Act, 1988 (w.e.f. 1.4.1988);

(ix) 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 or nature whatsoever;
Explanation: For the purposes of this sub-clause:

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

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

(x) 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;

(xi) 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.

(xii) any sum referred to in clause (va)* of Section 28, i.e. any sum, whether received or receivable in cash or kind, under an agreement for—

(a) not carrying out any activity in relation to any business; or

(b) not sharing any know-how, patent, copyright, trade-mark, 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:

Provided that sub-clause (a) shall not apply to—

(i) any sum, whether received or receivable, in cash or in kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains";

(ii) any sum received as compensation, from the multilateral fund of the Monetreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Explanation — For the purpose of this clause,—

(i) "agreement" includes any arrangement or understanding or action in concert,—

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(ii) "service" means service of any description which is made available to

* Substituted by finance Act, 2003 w.e.f. 1.4.2003
potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.”

(xiii) any sum referred to in clause (v) of sub-section (2) of Section 56.

(xiv) any sum referred to in clause (vi) of sub-section (2) of Section 56.

(xv) any sum of money or value of property referred to in clause (vii) or clause (viia) of sub-section (2) of Section 56 (Inserted by Finance Act, 2010 w.e.f 1st June 2010).

Concept of Income:

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

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

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

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

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

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

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

- Revenue Receipts are taxed unless they are specifically exempted whereas Capital Receipts are exempt unless they are specifically taxed.
- The word Income includes Loss.
- The income derived from illegal means or by committing a crime or violating the law does not affect the liability to tax. For instance, income derived from smuggling is taxable as any other income. Further the tax payer would be penalised under the relevant provisions of the statute, which was violated by him, is totally immaterial in considering the applicability of the provisions of the Income-tax Act.
- Anything which can properly be described as income is taxable under the Act unless expressly exempted.
- Upto assessment year 1972-73, receipts of a casual and non recurring nature were exempt from tax. The concept of income has been enlarged by the Finance Act, 1972 with effect from assessment year 1973-74, by including winning 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.

Case Laws:

(1) In Bhagwan Dass Jain v. Union of India (1981) 128 ITR 315 SC hold that the expression income includes not merely what is received or what comes in by exploiting the use of a property but also what one saves by using it oneself. It follows that in addition to aforesaid receipts appended in Section 2(24) (which does not define the term income but merely describes the various types of receipts as income), any other receipt is taxable under the Act if it comes within the general and natural meaning of the term income.

(2) A full Bench of the Allahabad High Court in the case of Amrit Kunwar v. CIT [(1946) 14 ITR 561] and the Bombay High Court in Vijay Kuverba v. CIT [(1963) 49 ITR 594] have laid down that income need not necessarily arise from any business activity, investment or outlay, or any enforceable obligation to usage, or traditional obligation; but mere casual payments or windfalls do not constitute income. The voluntary payments, in order to be taxable in the hands of recipient as income, must have an origin which a practical man would regard as a real source of income. However, it may be noted that a voluntary payment or gift may, in appropriate cases, be taxable as income even if it has no origin in any obligation to pay and even if the recipient would have no right of action in case of non-payment. [For details refer Section 10(3)].

(3) The concept of income has been clarified by three decisions of the Privy Council. In CIT v. Shaw Wallace & Co. (6 ITC 178), Sir George Sowndes has defined income as follows. Income connotes a periodical monetary return coming in with some sort of regularity, or expected regularity from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of
a mere windfall. Thus, income has been likened picturesquely to the fruit of a tree, or the crop of a field. It is essentially the produce of something which is often loosely spoken of as 'Capital.' But capital, though possibly the source in the case of income from securities, is in most cases hardly more than an element in the process of production.

### Test Your Knowledge

1. Gifts received in kind are not taxable subject to a fair value maximum of ₹___________

2. Circulars are binding on Income Tax Authorities as well as assesses. True or False.

### 1.2.2 Person [Section 2(31)]

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

- an individual:
- a Hindu undivided family:
- a company
- a firm
- an association of persons or a body of individuals whether incorporated or not:
- a local authority:
- every artificial, juridical person, not falling within any of the above categories:

(a) **an individual**: a natural human being, i.e. male, female, minor or a person of sound or unsound mind.

(b) **a Hindu undivided family**: it consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. 

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

(c) **a company**:  
Section 2(17) defines the term ‘company’ to mean:  
(i) any Indian company, or  
(ii) any body corporate incorporated by or under the laws of a country outside India i.e. a foreign company, or  
(iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970, or  
(iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special
order of the Board to be a company only for such assessment year or assessment years (whether commencing before the first day of April, 1971 or, on or after that date), as may be specified in the declaration.

**Indian Company:** According to Section 2(26) of the Act, Indian Company means a company formed and registered under the Companies Act, 1956 and includes:

(i) 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 Section 2(26)(iii),

(ia) a corporation established by or under a Central, State or Provincial Act,

(ib) any institution, association or body which is declared by the Board to be a company under Section 2(17),

(ii) in the case of State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in the State.

(iii) 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.

In all the above cases, it is necessary that the registered or, as the case may be, the principal office of the company, corporation, institution, association or body is in India.

**‘Principal Officer’**

The expression Principal Officer has been defined in Section 2(35). Principal Officer, used with reference to a local authority or a company or any other public body or any association of persons or any body of individuals means:

(a) the secretary, treasurer, manager or agent of the authority, company, association or body, or

(b) any person connected with the management or administration of the local authority, company, association or body upon which the Assessing Officer has served a notice of his intention of treating him as the Principal Officer thereof.

**Case Laws:**

The Andhra Pradesh High Court held in the case of *Income-tax Officer, A Ward Nellore v. Official Liquidator* (1975, 100 ITR 44) that official liquidator scrutinizing under Section 497(6) of the Companies Act, 1956 in the records of a company in voluntary liquidation, is not the Principal Officer within the meaning of Section 2(35) of the Act. If he is not a principal officer, he has no liability or duty to file any income-tax return. However, an official liquidator, even though having no assets of the company, can be treated as principal officer of the company after serving a notice on him proposing to treat him as the principal officer. [*ITO v. Official Liquidator* (1977) 106 ITR p. 119 (A.P.)] but the consent of the person concerned is not necessary. [*Rama Devi Agarwalla v. CIT* (1979) 117 ITR p. 256 (Cal.)].
In order to make a person the principal officer, the connection must be with the management or administration of the company. It is not necessary that the person concerned should be actually managing or administering the company. It is sufficient that the person is connected with such management or administration. What is important is that the person so connected must be served by the Assessing Officer with a notice setting out his intention to treat such person as the principal officer of the company. The intention of the Assessing Officer on this aspect of the matter must be based on some material. Therefore, the requirements of law are fulfilled if, prima facie, on materials which have rational connection with the finding that the person concerned can be treated as the principal officer, the Assessing Officer indicates his intention to him, treating him as the principal officer. It has, thus, been held that the Assessing Officer may treat any member of an association of persons as its principal officer even without the consent of the other members [Hungerford Investment Trust Ltd. v. ITO (1977) 106 ITR 649 (Cal.) confirmed in (1983) 142 ITR 601 (Cal.). And, Rama Devi Agarwalla v. CIT (1979) 117 ITR 256 (Cal.).]

Further, it has been held in Hungerford Investment Trust Ltd. v. ITO (1983) 142 ITR 601 (Cal.) that a person need not be heard before being treated as the principal officer of the company and the question can be determined at the time of assessment. Nevertheless, for a prosecution under Section 276B, a notice under Section 2(35)(b) is necessary [Pratap (MR) v. ITO (1984) 149 ITR 798 (Mad.).]

(d) a firm: i.e. a partnership firm whether registered or not.

(e) an association of persons or a body of individuals whether incorporated or not: The difference between Association of persons and body of individuals is that whereas an association implies a voluntary getting together for a definite purpose, a body of individuals would be just a body without an intention to get-together. Moreover, the members of body of individuals can be individuals only whereas the members of an association of persons can be individual or non-individuals (i.e. artificial persons).

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

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

Explanation: For the purposes of this clause, an association of persons or a body of individuals or a local authority or an artificial juridical person shall be deemed to be a person, whether or not such person or body or authority or juridical person was formed or established or incorporated with the object of deriving income, profits or gains.

1.2.3 Assessee

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

(a) every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable or to determine the loss sustained by him or by such other person or to determine the amount of refund due to him or to such other person.

(b) every person who is deemed to be an assessee under any provision of this Act.

(c) every person who is deemed to be an assessee in default under any provision of this Act.

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

The expression “other sum of money” includes

— fine, interest, penalty and tax or

— person to whom any refund of tax etc. is due under the Act or

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

There are certain provisions in the Act under which a person is deemed to be an assessee. These provisions shall be dealt with in the subsequent lessons.

1.2.4 Assessment Year [Section 2(9)]

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

1.2.5 Previous Year (Section 3)

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

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

**Example 1**

Y sets up a new business on May 15, 2011. What is the previous year for the assessment year 2012-13.

Previous year for the assessment year 2012-13 is the period commencing on May 15, 2011 and ending on March 31, 2012.

**Example 2**

A joins an Indian company on February 17, 2011. Prior to joining this Indian company he was not in employment nor does he have any other source of income. Determine the previous year of A for the assessment years 2011-12 and 2012-13.

Previous years for the assessment years 2011-12 and 2012-13 will be as follows:

<table>
<thead>
<tr>
<th>Previous year</th>
<th>Assessment year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb. 17, 2011 to March 31, 2011</td>
<td>2011-12</td>
</tr>
<tr>
<td>April 1, 2011 to March 31, 2012</td>
<td>2012-13</td>
</tr>
</tbody>
</table>

1.3 Residential status and tax liability (Section 6)

The incidence of liability to income-tax depends in every case upon the residential status and source of income of the assessee. Section 5 of the Act defines the scope of total income and the liability to tax that income in terms of the residential status of the assessee. The section classifies tax payers into three broad categories viz:

(i) Resident  
(ii) Non-resident  
(iii) Not ordinarily resident (only for Individuals and HUF)

1.3.1 Test for Residence of Individuals

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

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

*The fact that an assessee is resident in India in respect of one year does not automatically mean that he would be resident in the preceding or succeeding years as well. Consequently, the residential status of the assessee should be determined for each year separately. This is in view of the fact that a person resident in one year may become non-resident or not ordinarily resident in another year and vice versa.*
Under Section 6(1) of the Income-tax Act, an individual is said to be resident in India in any previous year if he:

(a) is in India in the previous year for a period or periods amounting in all the one hundred and eighty-two days or more i.e., he has been in India for at least 182 days during the previous year; or,

(b) has been in India for at least three hundred and sixty-five days during the four years preceding the previous year and has been in India for at least sixty days during the previous year except in following cases:

— Citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship, or for the purpose of employment outside India, or

— Citizen of India or Person of Indian origin engaged outside India (whether for rendering service outside or not) and who comes on a visit to India in the any previous year.

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

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

If an individual does not satisfy any of the above condition he will be said to be NON-RESIDENT.

An individual is not ordinarily resident in any previous year if he has been a non-resident in India in at least nine out of the ten previous years preceding that previous year, or has during the seven previous years preceding that previous year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less.

Thus, it can also be said that an individual may become a resident and ordinarily resident in India if he has satisfy both the following conditions given u/s 6(1)besides satisfying any one of the above mentioned conditions:

(i) he is a resident in any two out of the ten previous years preceding the previous year, and

(ii) he has been in India for 730 days or more during the seven previous years preceding the relevant previous year.

It must also be noted that the residential status of an individual for tax purposes is neither based upon nor determined by his citizenship, nationality and place of birth or domicile. This is because of the fact that, for tax purposes, an individual may be resident in more than one country in respect of the same year. The common feature in both the above conditions is the stay of the individual in India for a specified period. The period of stay required in each of the conditions need not necessarily be continuous or consecutive nor is it stipulated that the stay should be at the usual
place of residence, business or employment of the individual. The stay may be anywhere in India and for any length of time at each place in cases where the stay in India is at more places than one, what is required is the total period of stay should not be less than the number of days specified in each condition.

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

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

- Citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship, or for the purpose of employment outside India.
  
  OR

- Citizen of India or of Indian origin engaged outside India (whether for rendering service outside or not) and who comes on a visit to India in the any previous year.

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

1.3.2 Tests of Residence for Hindu Undivided Families, Firms and other Associations of Persons

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

A HUF, firm or other association of persons is said to be resident in India within the meaning of Section 6(2) in any previous year, if during that year the control and management of its affairs is situated wholly or partly in India during the relevant previous year. If the control and management of its affairs is situated wholly outside India during the relevant previous year, it is considered non resident.
A HUF can also be “not ordinarily resident” if manager/karta has been a not ordinarily resident in India in the previous year in accordance with the tests applicable to individuals. Firms, association of persons, local authorities and other artificial juridical persons can be either resident (ordinarily resident) or non-resident in India but they cannot be not ordinarily resident in India. Where, during the last ten years the kartas of the H.U.F. had been different from one another, the total period of stay of successive kartas of the same family should be aggregated to determine the residential status of the karta and consequently the H.U.F.

Even if negligible portion of the control and management of the affairs is exercised from India, it will be sufficient to make the family, firm or the association resident in India for tax purposes. For instance, if the affairs of a firm are controlled partly from India and partly from Bangladesh, the firm could be resident both in India and in Bangladesh.

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

**Meaning of Place of control and management:**

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

- Generally, the control and management of a business organization is said to be exercised from the place where its head office or administrative office is located.
- This office may or may not be the registered office of business enterprise. For instance, in the case of a firm the place of its control and management will be the place at which the partners hold their meetings, take decisions and issue directions, regardless of the places from where the ordinary business of the firm is carried on.
- The control and management referred to in this context should be that control which is exercised from the place concerned with some degree of permanence although there is nothing in the law which stipulates that the place of control and management of the affairs should not be changed from year to year or from place to place even within the same year.
- The mere receipt of information concerning the accounts and other financial affairs of a firm or family in India does not, however, amount to the control and management of the firm or family being exercised from India.

In case of H.U.F.:

- In the case of a H.U.F., the control and management of its affairs is normally said to be exercised from the place where the karta resides and issues directions.
- There may be cases where the affairs of H.U.F. may be controlled from India although the whole or a part of its business may be carried outside India. This would mostly be so in cases where the karta of the family is not resident in India.
- There may also be cases where the families affairs may, in the absence of its karta from India throughout the year, be controlled by any other coparcener of the family; even in such cases the residential status of the family would not be determined by the place of the kartas stay but only by the place of the control and management of its affairs [Annamalai Chettiar v. ITO 1958 34 ITR 88 (Mad.)]. Thus, a H.U.F. resident in India in 1989-90 would continue to be resident in India in 1990-91 if the control and management of its affairs is exercised in 1990-91 by its members even if the karta is abroad throughout. Karta means de-facto Karta.

Case laws:

Subbayya Chettiar v. C.I.T. (1951) 19 I.T.R. 168

The leading case on the construction of the clause control and management is Subbayya Chettiar v. C.I.T. (1951) 19 I.T.R. 168 which was concerned with the residence of a Hindu undivided family. The following propositions are established by the judgement of the Supreme Court in this case:

(i) Normally a Hindu undivided family is presumed to be resident in India unless
the assessee proves that the control and management of its affairs issituated wholly outside India.

(ii) The word affairs must mean affairs which are relevant for the purpose of this Act and which have some relation to the income sought to be assessed. Mere activity by the family or its karta in a place does not create residence. The place of control and, therefore of residence, may be different from the place where the family does a great deal of business.

(iii) The seat of the management and control of the affairs of the family may be divided and, if so, the family may have more than one residence.

(iv) If the seat of management and control is abroad, it would need much more than bare ‘activities in India’ to support a finding that the seat of management and control had shifted or that a second centre for such management and control had been started in India. Occasional or sporadic visits of a non-resident Karta to the place where the family business is carried on in India, or casual directions given in respect of the business while on such visits, would be insufficient to make the family resident in India.

All the above principles would be applicable to determine the residential status of association of persons, local authorities and other artificial juridical persons as well.

1.3.3 Tests of Residence for Companies

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

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

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

As a rule, the direction, management and control, the head, seat and directing power of a company's affairs is situated at the place where the directors meetings are held.

Consequently a company would be resident in the country if the meetings of directors who manage and control the business are held there. Narottam & Pereira Ltd. v. C.I.T. (1953) 23 ITR 454 (Bom.). It is not what the directors have power to do, but what they actually do, that is of importance in determining the question of the place where the control is exercised. (Egyptian Hotels Ltd. v. Mitchell 6 T.C. 542). In this case Lord Sumner said:
Where the directors forbore to exercise their powers, the bare possession of those powers was not equivalent to taking part in or controlling the trading. Control means *de facto* control and not merely *de jure* control.

The control and management of a company’s affairs is not situated at the place where the shareholders meetings are held, even if one shareholder, by reason of his holding an absolute majority of shares, has a decisive voice in matters relating to the company’s affairs.

It should be noted that the test for ascertaining the residential status of a non-Indian company on the basis of the control and management of its affairs is exactly opposite to that applied in the case of firms or HUF. A company will be resident in India only if the whole of the control of its affairs is exercised from India while a firm will be resident even if a very small portion is exercised from India.

It must be noted that only an individual or a HUF can be resident, not ordinarily resident or non-resident in India. All other assessees 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.

*Illustration:*

(a) Mr. P, an Indian Citizen, is living in Delhi since 1960, left for Japan on July 1, 2007. He comes back on August 7, 2011. Determine his residential status for the assessment year 2012-13.

(b) Dr. Q, an Indian Citizen and a Professor in IIM, Lucknow, left India on September 15, 2011 for USA to take up Professor’s job in MIT, USA. Determine his residential status for the assessment year 2012-13.

(c) Mr. R is a foreign citizen. Determine his residential status for the assessment year 2012-13 on the assumption that during financial years 1997-98 to 2011-12, he was present in India as follows:

<table>
<thead>
<tr>
<th>P.Y.</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-2012</td>
<td>185 days</td>
<td>2003-04</td>
</tr>
<tr>
<td>2010-2011</td>
<td>85 days</td>
<td>2002-03</td>
</tr>
<tr>
<td>2009-2010</td>
<td>275 days</td>
<td>2001-02</td>
</tr>
<tr>
<td>2008-2009</td>
<td>75 days</td>
<td>2000-01</td>
</tr>
<tr>
<td>2007-2008</td>
<td>200 days</td>
<td>1999-00</td>
</tr>
<tr>
<td>2006-2007</td>
<td>90 days</td>
<td>1998-99</td>
</tr>
<tr>
<td>2005-2006</td>
<td>150 days</td>
<td>1997-98</td>
</tr>
<tr>
<td>2004-2005</td>
<td>30 days</td>
<td></td>
</tr>
</tbody>
</table>

*Solution:*

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

Mr. P has stayed in India for 236 (viz. 24 + 30 + 31 + 30 + 31 + 31 + 28 + 31) days in the previous year 2011-12. So, this test is satisfied.

So, Mr. P shall be a resident in India during the previous year 2011-12. (Assessment year 2012-13).

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

— He is resident in two out of ten previous years preceding the relevant
previous year.
— His stay in India is also more than 730 days in 7 previous years preceding the relevant previous year. As he left for Japan on 1st July 2007.

Hence, Mr. P is resident and ordinary resident in India for the assessment year 2012-13.

(b) Dr. Q being a citizen of India and who has gone out of the country for employment, will be governed by 182 days test. Dr. Q is an Indian citizen and leaves India for the purpose of employment therefore the second condition under section 6(1) shall not be applicable.

Dr. Q has been a citizen of India he is in India for 167 (viz. 30 + 31 + 30 + 31 + 31 + 14) days only in the relevant previous year.

Hence, Dr. Q shall be a non-resident in India for the assessment year 2012-13.

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Presence in India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-2012</td>
<td>185</td>
</tr>
<tr>
<td>2010-2011</td>
<td>85</td>
</tr>
<tr>
<td>2009-2010</td>
<td>275</td>
</tr>
<tr>
<td>2008-2009</td>
<td>75</td>
</tr>
<tr>
<td>2007-2008</td>
<td>200</td>
</tr>
<tr>
<td>2006-2007</td>
<td>90</td>
</tr>
<tr>
<td>2005-2006</td>
<td>150</td>
</tr>
<tr>
<td>2004-2005</td>
<td>30</td>
</tr>
<tr>
<td>2003-2004</td>
<td>300</td>
</tr>
<tr>
<td>2002-2003</td>
<td>150</td>
</tr>
<tr>
<td>2001-2002</td>
<td>200</td>
</tr>
<tr>
<td>2000-2001</td>
<td>180</td>
</tr>
<tr>
<td>1999-2000</td>
<td>20</td>
</tr>
<tr>
<td>1998-1999</td>
<td>40</td>
</tr>
<tr>
<td>1997-1998</td>
<td>300</td>
</tr>
</tbody>
</table>

The following facts are now available:
(i) Stay of Mr. R during the previous year 2011-12 is 185 days.
(ii) Mr. R is resident in India in two out of ten previous years preceding the relevant previous year.
(iii) Stay of Mr. R in India is also more than 730 days in 7 previous years preceding the relevant previous year.

Hence, Mr. R shall be a resident and ordinary resident for the assessment year 2012-13.

1.4 Computation of Taxable Income and Tax liability of an assessee:

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

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

2. Calculate the income as per the provisions of respective heads of income.
   Section 14 classifies the income under five heads:
   (i) Income from salaries
   (ii) Income from House Property
   (iii) Profits and gains of business or Profession
   (iv) Capital Gains
   (v) Income from other sources

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

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

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

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

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

8. Calculate income tax on the net agricultural income as increased by ₹ 1,80,000/1,90,000/2,50,000/5,00,000 as the case may be, as if such increased net agricultural income were the total income.

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

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

11. The balance of amount of income tax left as per (9) above plus the amount of income tax at (10) above will be the income tax in respect of the total income.

12. Deduct the following from the amount of tax calculated under (11) above:
   - Tax deducted and collected at source.
   - Advance tax paid.
   - Double taxation relief.

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

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

(A) Income Tax Rates for Assessment Year 2012-13
Applicable for Individual, HUF, AOP & BOI

<table>
<thead>
<tr>
<th>Annual Income From All Sources Except Long Term Capital Gains (after All Permissible Deduction)</th>
<th>Income Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>For any individual (resident or non-resident), every HUF/AOP//BOI/artificial juridicial person</td>
<td></td>
</tr>
<tr>
<td>Upto ₹ 1,80,000</td>
<td>NIL</td>
</tr>
<tr>
<td>₹ 1,80,001 to ₹ 5,00,000</td>
<td>10%</td>
</tr>
<tr>
<td>₹ 5,00,001 to ₹ 8,00,000</td>
<td>20%</td>
</tr>
<tr>
<td>Above ₹ 8,00,000</td>
<td>30%</td>
</tr>
<tr>
<td>For resident Women below 60 years at any time during the previous year.</td>
<td></td>
</tr>
<tr>
<td>Upto ₹ 1,90,000</td>
<td>NIL</td>
</tr>
<tr>
<td>₹ 1,90,001 to ₹ 5,00,000</td>
<td>10%</td>
</tr>
<tr>
<td>₹ 5,00,001 to ₹ 8,00,000</td>
<td>20%</td>
</tr>
<tr>
<td>Above ₹ 8,00,000</td>
<td>30%</td>
</tr>
<tr>
<td>For resident senior citizen (who is of 60 years but less than 80 years during the previous year)</td>
<td></td>
</tr>
<tr>
<td>Upto ₹ 2,50,000</td>
<td>NIL</td>
</tr>
<tr>
<td>₹ 2,50,001 to ₹ 5,00,000</td>
<td>10%</td>
</tr>
<tr>
<td>₹ 5,00,001 to ₹ 8,00,000</td>
<td>20%</td>
</tr>
<tr>
<td>Above ₹ 8,00,000</td>
<td>30%</td>
</tr>
<tr>
<td>For resident senior citizen (who is of 80 years during the previous year)</td>
<td></td>
</tr>
<tr>
<td>Upto ₹ 5,00,000</td>
<td>NIL</td>
</tr>
<tr>
<td>₹ 5,00,001 to ₹ 8,00,000</td>
<td>20%</td>
</tr>
<tr>
<td>Above ₹ 8,00,000</td>
<td>30%</td>
</tr>
</tbody>
</table>

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

(C) **Companies:** Domestic Company @ 30% and Foreign Company @40% and 50% in case of certain specific incomes.
(D) Surcharge:
For Individual, HUF, Firm, local authority, AOP, BOI and co-operative society
No surcharge shall be levied from assessment year 2010-11 onwards.
For others
5% surcharge in case of domestic Company and 2% in case of every company other than a domestic company. If total income exceeds rupees one crore.

(E) Education Cess
The amount of income-tax as computed including surcharge thereon shall be increased by an Education Cess on Income Tax by 2% for the purpose of fulfilling the commitment of the Central Government to provide and finance universalized basic education and 1% secondary and higher education cess is also to be impost i.e. now it will be 3%.

LESSON ROUND UP

- This Chapter elucidates the manner in which the Income Tax Act was introduced.
- It deals with important definitions of the Income Tax Act which will be used again in various chapters.
- Residential Status of various persons.
- Brief the steps involved for computing Total Income and Tax Liability.
- Deals with the tax rates applicable for individuals, HUF, AOP, BOI, Firm and Company.

SELF TEST QUESTIONS

1. Explain the following terms:
   (a) Previous year;
   (b) Assesssee;
(c) Income.

2. What are the different categories into which the assesseses are divided regarding residence and how is the residence of assesseses determined for income-tax purposes? Explain.

3. 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.
2.1 CAPITAL AND REVENUE RECEIPTS (CONCEPTUAL ANALYSIS)

Income-tax, as the name implies, is a tax on income and not a tax on every item of money received. Therefore, unless the receipt in question constitutes income as distinguished from capital, it cannot be charged to tax. For this purpose, income should be distinguished from capital which gives rise to income. The following are the important principles on which the distinction between capital and revenue is based.

**Distinction between a Capital receipt and Revenue receipt**

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

**Type of Capital**

1. **Fixed capital**

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

2. **Circulating Capital**

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

**Type of capital will depend upon the nature of business**

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

**Nature of receipt also depends upon the reference to the recipient**

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

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

2.2 **CAPITAL AND REVENUE RECEIPTS IN RELATION TO BUSINESS ACTIVITIES**

**Receipts chargeable to tax:**

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

Examples of these type of receipts are:

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

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

**Conditions where the receipt is taxable irrespective of its nature:**

If the income is from a trading activity it would be liable to tax but not otherwise. Where the transactions are partly in the course of trade and partly outside the normal trading activities of the assessee and the profits derived therefrom are a composite sum, the profits must be apportioned between two parts as capital and revenue and the revenue portion would alone be taxable as business income.

**On transfer of capital asset:**

While profits and gains arising from the sale or other transfer of a capital asset are taxable as capital gains and taxable under head income from capital gains, profits arising from the transfer of a trading asset i.e., stock-in-trade would be taxable as business income. Since even an isolated transaction may constitute an adventure in the nature of trade, whether a particular asset sold by the assessee is a capital asset or a current asset will have to be decided on the basis of the assessee’s intentions with which the asset was originally acquired, the frequency or recurrence of similar transactions being immaterial.

**Taxable only if there is profit or loss in actual:**

But the question of determining whether a particular item is capital or revenue would come up for consideration only when there is, in reality, some profit or gain. For instance, mere appreciation in the value of a capital asset would not give rise to any income because unrealised capital accretions do not represent and are not taxable as profit or gain. This principle would apply even when the transactions are between a firm and its partners. In other words, when a partner of a firm hands over to the firm his capital assets at a value much higher than the cost of their acquisition, he cannot be said to have derived any profit and consequently the question of taxing the same as revenue or capital profits should not arise but for two provisions contained in Sections 45(3) and 45(4) of the Act.

More on this later in the study material dealing with capital gains. The same principal would have to be followed even when the assessee revalues his assets at a higher figure. But when a person transfers his assets to a company of which he is the principal shareholder, he must be treated as having derived profits and consequently the test for determining the capital or revenue character of the receipts must be applied for tax purposes.

Where profits arise from the purchase and sale of shares and securities, the capital or revenue character of the same must be determined from the motive, purpose and intention behind the acquisition of these shares. If the taxpayer had acquired the shares as an investor or for the purpose of getting a controlling interest in the company’s business or for obtaining a selling agency or to get a prominent position as a director, the profits derived on sale of the shares, etc. would be of a capital nature. But if the shares were acquired by the assessee as a dealer in shares or with a speculative motive the profit would be of revenue nature taxable as
business income. These principles would apply as well to other assets like land, buildings or other capital assets.

**Taxable income in relation to Annuities:**

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

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

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

**Taxable income vis-à-vis Compensation**

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

**Taxable income vis-à-vis Subsidies and grants:**

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

**Taxable income vis-à-vis debenture:**

For debenture holder the premium on redemption or the discount on issue of the debentures by the company would be a capital receipt and would not consequently be liable to tax. In the case of the issuing company also, the premium or discount on the issues of shares and debentures or on their redemptions would be on capital account. But the discount on loans advanced at a discount and repayable at a premium would be a revenue receipt in the hands of a person whose business is that of money-lending if the loans had been advanced in the ordinary course of the assessee's business without taking any extra commercial consideration as the cases. In all other cases, such a discount would be on capital account. However, the premium (salami) - a single payment made for the acquisition by the lessee of the right to occupy and enjoy the benefits granted to him under the lease of any land, building or other capital asset - is normally a capital receipt since the rights acquired or given under the lease by virtue of the payment of salami constitute a capital asset. But if the premium takes the character of advance rent (instead of the price paid for parting with and giving possession of the capital asset) the receipt would be taxable as income.

**Taxable income vis-à-vis Royalties:**

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

**Taxable income vis-à-vis Devaluation in foreign currency:**

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

**Exceptions where capital receipt are taxable:**

It must, however, be noted that the fact that a particular receipt is of a capital nature does not mean that it is totally outside the scope of taxation. If the profit arises from the transfer of a capital asset it would be taxable as capital gains. Although the
general principle of law is to tax only revenue receipts as income, there are three exceptions to this rule under which capital receipts are also taxable as income, viz.:

(i) Any compensation received for termination of employment or modification of the terms of employment would fall within the meaning of a profit in lieu of salary and consequently taxable as salary income. [Section 17(3)(i)]

(ii) Any compensation received for termination of managing agency or other contractual relationship in relation to the management of whole or substantially the whole of the affairs of a company or the modification of the terms and conditions relating thereto would be taxable as income from business. [Section 28(ii)(a and b)]

(iii) Any compensation or other payment due to or received by any person for the termination or the modification of the terms of any other agency held by him in India in relation to the business of any other person would also be taxable as income from business regardless of the nature of the agency business. [Section 28(ii)(c)].

Factors that do not determine the nature or character of receipt:

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

(i) **Character and source of income:**

The nature of receipt should be decided entirely on the basis of its character in the hands of the recipient, the source from which the payment has been received being immaterial for the purpose. For instance, there may be cases where the payer makes the payment out of capital while the recipient gets it as income. This may happen in cases like the payment of interest out of capital under Section 208 of the Companies Act, 1956 which the recipient gets as income chargeable to tax. Another instance would be of a businessman who deals in plant and machinery; while the purchaser of the machinery would pay the price out of his capital, the seller would get it as income from business. Therefore, the taxability of the receipt does not depend upon the character of payment in the hands of the payer.

(ii) **Application of income:**

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

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

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

(iv) **Treatment given in the books:**

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

(v) **Magnitude and method of payment:**

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

(vi) **Basis for measurement of the receipt:**

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

(vii) **Ways or devices resorted by payer:**

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

**Illustration:**

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

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

Solution:

1. Receipt in substitution of a source of income is a capital receipt. Therefore, the amount received by AB & Co. from CD & Co. for premature termination of an agency contract is a capital receipt though the same is taxable under Section 28(ii)(c).

2. Sales-tax is the liability of a seller to pay to the Government on the sale of goods made by him, which is allowed as deduction as revenue expenditure. If any part of Sales-tax is collected from the buyer of goods, that may be treated as a revenue receipt. Thus the sales-tax collected from the buyer of goods is a revenue receipt.

3. Receipt of lump sum royalty in lieu of future royalties is a revenue receipt, as it is an income from royalty.

4. Amount spent by a company for sending its production manager abroad to study new methods of production is a revenue expenditure to be allowed as a deduction. Because the new knowledge and exposure of that manager will assist the company in improving its existing methods of production etc.

5. This is a capital expenditure, as any expenditure incurred by a person to free himself from a capital liability is a capital expenditure. In the given case, the payment of ₹ 50,000 for cancelling the order for purchase of the machinery, has helped the assessee to become free from an unnecessary capital liability.

6. The amount of ₹ 1,75,000 received for not resigning from the directorship is a reward received from the employer. Therefore it is a revenue receipt.

LESSON ROUND UP

- This chapter analyses the fundamental concepts of Capital and Revenue Receipts.
- The interpretation of these concepts in light of taxing provisions are analysed under various heads of Income.
SELF TEST QUESTIONS

1. Distinguish between Capital and Revenue Receipts.
STUDY III
BASIS OF CHARGE, SCOPE OF TOTAL INCOME AND RESIDENTIAL STATUS

LEARNING OBJECTIVES
To understand the:
- Concept of basis of Charge of Income-tax (Section 4)
- Meaning and Scope of Total Income (Section 5)
- Apportionment of income between spouses governed by Portuguese civil code (Section 5A)
- Residential status and its incidence on tax liability (Section 6)

3.1 Charge of Income-tax (Section 4)

Section 4 of the Act is the most effective and operative of the various provisions in the Act since, it is because of this section alone that all the other sections become enforceable. The charging section being the backbone of the Act, it lays down the provisions as to what are taxable and at what rates; income of which period is taxable and in whose hands. Accordingly, the section provides that:

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

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

3.1.1 Exceptions:

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

However there are five exception to this rule:

(a) Assessment of non-residents in respect of their income from shipping business (Section 172).

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

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

(d) Assessment of persons trying to alienate their assets with the object of avoiding liability to tax (Section 175).

(e) Assessment of the income from discontinued business (Section 176).

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

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

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

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

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

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

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

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

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

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

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

The provisions of Section 174 [already discussed under para 2] shall apply to the proceedings under this Section also.

(e) Discontinued business (Section 176)

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

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

Example, if a business is discontinued on 14-08-2011 then the income for period 1-04-2011 to 14-08-2011 may be assessed in the assessment year 2012-13 itself and the tax will be charged at the rates applicable for advance tax payable during financial year 2011-12.

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

3.2 Meaning and Scope of Total Income (Section 5)

Section 4 of the Act imposes a charge of tax on the total or taxable income of the
assessee. The meaning and scope of the expression of total income is contained in Section 5. The total income of an assessee can not determined unless we know the residential status in India during the previous year.

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

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

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

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

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

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

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

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

The scope of total income of a not-ordinarily resident assessee would be the same as that of a resident and ordinarily resident except for the fact that the income accruing or arising outside India would not be included in his total income unless it is derived from a business controlled in or profession set up in India. To sum up, income which accrues or arises or is deemed to accrue or arise in India or income received or deemed to be received in India would be taxable as part of total income in the hands of every person irrespective of the fact whether he is a resident or non-resident in India; but, only resident assessees are chargeable to tax in respect of income which accrues or arises or is received outside India.

Therefore, the scope of total income and consequently the liability to income-tax also depends upon the following facts:

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

3.2.1(i) Income received:

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

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

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

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

(iii) While considering the receipt of income for tax purposes both the place and the date of its receipt must be taken into account. The income in question should be not only received during the accounting year relevant to the assessment year but must also be received in India in order to constitute the basis of taxation. Thus, if an item of income is first received outside India and after a few years is brought into India the subsequent receipt of the same amount in India should not be taken as the basis of taxing the same since the same income cannot be received twice and it will be known as Remittances.

(iv) For the purpose of taxation both actual and constructive receipt must be taken into account. Receipt by some other person on behalf of the assessee should be treated as receipt by the assessee for being taxed in his hands.

(v) The question of taxability of a particular income received by the assessee depends upon the nature of income. For instance, income from salaries and interest on securities would attract liability to tax immediately when it falls due to the assessee regardless of its actual receipt by or on behalf of the assessee.

Place and date of receipt of income:

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

(i) Date of receipt when receipt is by cheque

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

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

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

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

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

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

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

(v) Payment by transfer of immovable property

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

(vi) Issuing receipt in advance

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

3.2.1(ii) Income deemed to be received:

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

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

(vi) The transferred balance in a Recognised Provident Fund to the extent provided in Rule 11(4) of Part A - Fourth Schedule [Section 7(ii)].

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

(vii) Any dividend declared by a Company or distributed or paid by it within the meaning of Section 2(22) [Section 8(a)].

(viii) Any interim dividend unconditionally made available by the Company to the member who is entitled to it [Section 8(b)].

(ix) The Supreme Court verdict in Standard Triumph Motor Co. Ltd. v. CIT (1993) 201 ITR 391, seems to have made the lot of non-residents in particular more vulnerable. The Court in that case held that a credit entry in the books of the buyer of goods or services in favour of the supplier of goods or services tantamounts to receipt of money by the latter. By equating credit entry with receipt itself the judgement exposes non-residents to Indian tax liability where they were not all along liable on the basis of mere credit entry. Because a resident is in any case liable to tax on his world income and therefore this judgement affects a non-resident more than it affects a resident.

3.2.1(iii) Income accrued:

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

Income is said to accrue only to that person who is lawfully entitled to that income. Income accrues at the place where the source of the income is situated, which may or may not be the same as the place from which the business activities are carried on. Normally, income accrues at the place where the contract yielding the income is entered into and for this purpose the contract should be taken to have been entered into at the place where the offer is accepted.
As already stated, the total income in the case of any non-resident assessee consists of:

(a) income received or deemed to be received in India, regardless of the place of its accrual, and

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

Case Laws:

Further in this connection, the following cases are worth noting.


   The assessee had been following mercantile system of accounting. He received rent for the period 1950 to 1958 on 17 November, 1960 pursuant to a compromise decree passed in July, 1959. It was held that the entire amount cannot be taxed in the assessment year 1961-62.


   Where income accrues outside India and the foreign Government restricts its repatriation, such restriction does not affect the accrual of income and the income is to be includible in assessment in India.


   Where accounts are maintained on mercantile system and on account of filing an appeal by the customer against the compensation granted by a court, the decretal amount was kept in suspense account, such amount was held to be assessable in the year of final decision and not in the year when the first decree was passed in its favour.

According to **Explanation 1 to Section 5** of the Act, in cases where income actually accrues or arises outside India, it should not be deemed to be received in India merely because of the fact that such income has been included in the profit and loss account and balance sheet prepared in India. This is because of the fact that mere entries in the books of accounts in India would not convert the place of actual accrual of income abroad into income accruing in India. Even in cases where the foreign income is not only included in the balance sheet but is also utilised for distribution of dividends by a company, the foreign income cannot be said to have accrued or been received in India. Thus, the place of actual accrual or receipt of income for tax purposes should be determined on the basis of the facts and circumstances of each case.
**Explanation 2 to Section 5** further provides that in every case where an item of income is once taxed on the basis of its accrual, it should not again be taxed in the hands of the same assessee on the basis of its receipt when it is subsequently received by him. For this purpose it is immaterial whether the assessee receives the income in the same or subsequent year. This is a specific provision intended to ensure that there is no double taxation of the same item of income in the hands of the same assessee. But the question whether a particular item of income should be taxed on the basis of its accrual or receipt must be determined with reference to the nature of income and the method of accounting regularly followed by the assessee.

3.2.1(iv) Income deemed to accrue or arise in India:

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

(a) *Income by virtue of business connection*

- Income arising through or from business connection to any assessee is deemed to accrue or arise in India where a business connection actually exists whether with or without a regular agency, branch or other type of commercial association.

- For purposes of deeming income to accrue or arise in India, the expression 'business connection' must be taken to have wider scope that what is commonly understood by it. It is entirely different from the carrying on of a business although business connection may have some direct or indirect relationship with the business carried on.

- The Supreme Court has held that business does not necessarily mean trade or manufacture only, it is being used as including within its scope professions, vocations and callings [Barendra Prasad Ray and Others v. I.T.O. (1981) ITR, p. 295].

- If income accrues to any person outside India by virtue of his business connection in India, whether directly or indirectly, that income must be deemed to accrue or arise in India for purposes of income-tax assessment.

- In cases where all the operations or activities of a business are not carried on in India but a part of them arise by virtue of the business connection in India, the income which is deemed to accrue or arise in India, should be taken to be only that part which could reasonably be attributed to the operations carried on in India. Rule 10 of the Income-tax Rules contains the basis on which the income attributable to the operations carried out in India could be deemed to accrue or arise in India.

- However, where a substantial part of a non-residents output is sold in the Indian market through brokers to various customers in India, or mere rendering of services outside India to a person carrying on business in India does not amount to a business connection in India.

- Similarly, where an Indian exporter selling goods through non-resident selling agents, receives sale price in India, credits commission on sales to non-resident agents in his books of account and remits the amount to them later, such commission to non-residents is neither received or deemed to be received in India nor deemed to accrue or arise in India [C.I.T. v. Toshoku Ltd. (1980) 125 ITR p. 525 (S.C.)].
THE MEANING OF THE EXPRESSION ‘BUSINESS CONNECTION’

The expression business connection includes:

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

(ii) the erection of a factory where the raw products purchased locally are processed or converted into some form suitable for export outside India;

(iii) appointing an agent or agents in India for the systematic and regular purchase of raw materials or other commodities or for the sale of the non-residents goods, or for any other purpose;

(iv) the formation of a close financial association between a resident and a non-resident company which may or may not be related to one another as a holding and subsidiary company;

(v) the formation of a subsidiary company to sell or otherwise deal with the products of the non-resident parent company;

(vi) the grant of a continuing licence to a non-resident for the purpose of exploitation for profit of an asset belonging to the non-resident even though the transaction in question may be treated as an out and out sale by the parties concerned.

(b) Tax Exemption for encouraging Export:

- For the purpose of encouraging exports, a specific tax concession has been given by providing that no income shall be deemed to accrue or arise in India to a non-resident through or from his operations which are confined to the purchase of goods in India for the purpose of export.

- This exemption is available to a non-resident even though he keeps an office agency for the purpose of buying and export. This exemption is, however, not available to residents or not ordinarily residents.

- In order to qualify for tax exemption, it is essential that the operations of the non-residents, although arising from business connection, should be confined to the purchase of goods for the purpose of export outside India.

- Consequently, the exemption would not be available if the goods purchased in India are sold in India or are not exported outside India.

- Further, if the non-resident works up the raw-materials into finished or semi-finished products, the exemption would be withdrawn and he would become chargeable on such portion of the profits as is attributable to his manufacturing it in India.

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

- Income arising in a foreign country from any property situated in India would
be deemed to accrue or arise in India.

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

- Income arising through or from any asset or source of income in India would also be deemed to accrue or arise in India.

- In this context, the term source means not a legal concept but something which a practical man would regard as a real source of income.

- The term property does not refer to the property dealt with by Sections 22 and 23, but it includes any tangible movable or immovable property. The term asset would, however, include all intangible rights and, consequently, interests, dividends, patents and copyrights, royalties, rents etc. will be assets.

*(d) Capital asset:*

- Capital gains arising to an assessee from the transfer of a capital asset situated in India would be deemed to accrue or arise in India irrespective of the fact whether the capital asset in question represents a movable or immovable property or a tangible or intangible asset.

- It is also immaterial whether the consideration for the transfer of the capital asset is actually paid or payable in India or outside.

- The place of registration of the document of transfer of property is equally immaterial.

- However, if the capital asset, prior to the transfer, is situated outside India, the provisions of Section 9(1) would not apply to deem the capital gains arising on the transfer as accruing or arising in India for purposes of its taxation in India.

*(e) Income from salaries*

- Income which is chargeable under the head Salaries is deemed to accrue or arise in India in all cases when earned in India. For this purpose income is said to be earned in India if the services are rendered in India.

- The actual place of accrual of the salaries, the residential status of the employer, the citizenship or nationality of the employee and whether the employee is a Government servant or an employee of private enterprise are immaterial.

- However, under Sub-section (2) of Section 9, any pension payable outside India to a person residing permanently outside India should not be deemed to accrue or arise in India if the pension is payable to civil servants and retired
judges provided they were appointed before the 15th August, 1947 and continued to serve after the constitution came into operation.

- Barring this exception, non-residents and not ordinarily residents entitled to receive salary or pension earned by them in India would be deemed to receive income which has accrued in India even though the income may be actually accruing and received outside India.
- Income from salaries payable by the Government to a citizen of India outside India for his services rendered outside India, is deemed to accrue or arise in India even though the income is actually accruing outside India and is also received outside India. Thus, under this provision, salary income of all Government servants, working outside India is deemed to accrue in India. In the absence of this provision they would not be chargeable to tax in respect of such income as they would, after some time, become non-residents.
- This provision to deem income as accruing in India applies only in respect of their income from salary but not in respect of the allowances and perquisites to which they are entitled to while serving in a foreign country.
- Section 10(7) of the Income-tax Act, 1961 contains a specific provision to exempt Government servants from tax on their services in a foreign country partly to meet the higher cost of living in that country.
- Salaries paid by the Indian Government in a foreign country to citizens of the foreign country should not, however, be deemed to accrue in India since this provision applies only to Indian citizens employed by the Government who are rendering service outside India.

(f) Taxability of Dividend:

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

Test Your Knowledge

Which of the following meaning does the expression 'Business Connection' take into account?

(a) Building a housing complex
(b) Maintenance of branch office
(c) Appointing an agent
(d) Formation of close financial association

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

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

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

3.4 Tax incidence vis-a-vis residential status:

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

<table>
<thead>
<tr>
<th>Where tax incidence arises in case of Income received in India (Whether accrued in or outside India)</th>
<th>Resident or Resident &amp; Ordinarily Resident</th>
<th>Resident but not Ordinarily Resident</th>
<th>Non-Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Description</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
</tr>
<tr>
<td>Income deemed to be received in India (Whether accrued in or outside India)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income accruing or arising in India (Whether received in India or outside India)</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Income deemed to accrue or arise in India (Whether received in India or outside India)</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Income received and accrued outside India from a business controlled or a profession set up in India</td>
<td>YES</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>Income received and accrued outside India from a business controlled from outside India or a profession set up outside India</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Income earned and received outside India but later on remitted to India (whether tax incidence arises at the time of remittance?)</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
</tr>
</tbody>
</table>

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

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

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

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

**Correct answer:** True

**Illustration:** Mr. A earns the following income during the previous year ended 31st March, 2012. Determine the income liable to tax for the assessment year 2012-13 if Mr. A is (a) resident and ordinarily resident in India, (b) resident and not ordinarily resident in India, and (c) non-resident in India during the previous year ended 31st March, 2012.

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

**Solution:** Computation of income liable to tax:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident &amp; Ordinarily Resident (₹)</th>
<th>Resident but not Ordinarily Resident (₹)</th>
<th>Non-Resident (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits on sale of a building in India but received in Holland</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Pension from former employer in India received in Holland</td>
<td>14,000</td>
<td>14,000</td>
<td>14,000</td>
</tr>
<tr>
<td>Interest on U.K. Development Bonds (1/4th taxable on receipt basis)</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Interest on U.K. Development Bonds (3/4th taxable on receipt basis)</td>
<td>15,000</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Income from property in Australia and received in U.S.A.</td>
<td>15,000</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>
Income earned from a business in Abyssinia which is controlled from Jullundur | 70,000 | 70,000 | 30,000
Dividend on shares of an Indian company but received in Holland | 10,000 | 10,000 | 10,000
Profits not taxed previously brought into India (Not an income so not taxable) | Nil | Nil | Nil
Profits from a business in Nagpur which is controlled from Holland | 27,000 | 27,000 | 27,000

Total | 1,76,000 | 1,46,000 | 1,06,000

Illustration: X had the following income during the previous year ended 31st March, 2012:
- Salary Received in India for three Months - ₹9,000
- Income from house property in India - ₹13,470
- Interest on Saving Bank Deposit in State Bank of India - ₹1,000
- Amount brought into India out of the past untaxed profits earned in Germany - ₹20,000
- Income from agriculture in Indonesia being invested there - ₹12,350
- Income from business in Bangladesh, being controlled from India - ₹10,150
- Dividends received in Belgium from French companies, out of which ₹2,500 were remitted to India - ₹23,000

You are required to compute his total income for the assessment year 2012-13 if he is: (1) a resident; (ii) a not ordinarily resident, and (iii) a Non-resident.

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident &amp; Ordinarily Resident (₹)</th>
<th>Resident but not Ordinarily Resident (₹)</th>
<th>Non-Resident (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary Received in India for three Months</td>
<td>9,000</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Income from house property in India</td>
<td>13,470</td>
<td>13,470</td>
<td>13,470</td>
</tr>
<tr>
<td>Interest on Saving Bank Deposit in State Bank of India</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Amount brought into India out of the past untaxed profits earned in Germany (not an income, hence not taxable)</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>
Income from agriculture in Indonesia being invested there  |  12,350  |  Nil  |  Nil  
Income from business in Bangladesh, being controlled from India (it is supposed that the money is not received in India)  |  10,150  |  10,150  |  Nil  
Dividends received in Belgium from French companies  |  23,000  |  Nil  |  Nil  
Total  |  68,970  |  33,620  |  23,470  

**Illustration:** Mr. Y earns the following income during the previous year ended on 31st March, 2012. Determine the income liable to tax for the assessment year 2012-13 if Mr. Y is (a) resident and ordinary resident (b) resident and not ordinary resident, and (c) non-resident in India during the previous year ended on 31st March, 2012.

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident &amp; Ordinarily Resident (₹)</th>
<th>Resident but not Ordinarily Resident (₹)</th>
<th>Non-Resident (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Honorarium received from Govt. of India</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Profits earned from a business in Tamilnadu controlled from Pakistan</td>
<td>50,000</td>
<td>50,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>
Profits earned from a business in U.K. controlled from Delhi | 30,000 | 30,000 | -
---|---|---|---
Profits earned from a business in USA controlled from Pakistan and amount deposited in a Bank there | 40,000 | - | -
---|---|---|---
Income from a house property in France, received in India | 10,000 | 10,000 | 10,000
---|---|---|---
Past untaxed foreign income brought into India during the year | - | - | -
---|---|---|---
Dividends from a foreign company credited to his account in Pakistan | 35,000 | - | -
---|---|---|---
Dividends declared but not received from an Indian company [u/s 10(33) enjoys exemption] | - | - | -
---|---|---|---
Agricultural income from Burma not remitted to India | 40,000 | - | -
---|---|---|---
Pension for Services rendered in India, but received in Pakistan | 30,000 | 30,000 | 30,000
---|---|---|---
Total | 2,55,000 | 1,40,000 | 1,10,000

**LESSON ROUND UP**

- This Chapter deals with the basis of charge, scope of total income and residential status and tax liability which has been dealt under sections 4, 5 and 6 of the Income Tax Act 1961.
- This chapter further more shows the close proximity between income assessed and income charged under the Act.
- This chapter also deals with income deem to accrue or arise in or outside India.
SELF TEST QUESTIONS

1. What do you understand by charge of Income tax as stated in section 4 of the Income tax Act?


4. How does the tax liability of a not ordinarily resident person differ from that of a resident and ordinarily resident person under the Income Tax Act? Explain.

5. Write short notes on the following:
   (a) Income deemed to be received in India.
   (b) Income deemed to accrue and arise in India.
STUDY IV

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

LEARNING OBJECTIVES

This Chapter 4 deals with incomes which do not form part of total income. This chapter covers Sections 10, 10A, 10B, 11, 12, 12A, 13 and 13A. Apart from Section 10, this chapter deals with special provisions for newly established units in special regions, issues relating to trusts, charitable organizations and other related matter.

This chapter covers the following topics/concepts and it is divided into four parts:

PART I

INCOME NOT TO BE INCLUDED IN TOTAL INCOME OF ANY PERSON

- Section 10
- Agricultural Income [Section 10(1)]
- Money received by an individual as a member of H.U.F. [Section 10(2)]
- Share of profit from partnership firm [Section 10(2A)]
- Interest Income of Non-residents [Section 10(4)]
- Interest Income of Non-residents from Specified Savings Certificates [Section 10(4B)]
- Travel Concession or Assistance to a Citizen of India [Section 10(5)]
- Exemptions to an Individual who is not a Citizen of India [Section 10(6)]
- Tax paid on behalf of Foreign Companies in respect of certain Income [Section 10(6A)]
- Income derived by a Foreign Company [Section 10(6B)]
- Income of foreign aircraft business from lease [Section 10(6BB)]
- Fees for technical services received by Foreign Companies [Section 10(6C)]
- Allowance Payable outside India [Section 10(7)]
- Co-operative Technical Assistance Programmes [Section 10(8)]
- Fee received by certain consultants out of funds made available to international organisation [Section 10(8A)]
- Remuneration received by certain individual in connection with any technical assistance programme [Section 10(8B)]
- Income of any Member of the Family [Section 10(9)]
<table>
<thead>
<tr>
<th>Description</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>Death-cum-Retirement Gratuity</td>
<td>10(10)</td>
</tr>
<tr>
<td>Commutation of Pension</td>
<td>10(10A)</td>
</tr>
<tr>
<td>Encashment of Earned Leave</td>
<td>10(10AA)</td>
</tr>
<tr>
<td>Retrenchment Compensation</td>
<td>10(10B)</td>
</tr>
<tr>
<td>Compensation Received by victims of Bhopal Gas Leak Disaster</td>
<td>10(10BB)</td>
</tr>
<tr>
<td>Payment received on Voluntary Retirement</td>
<td>10(10C)</td>
</tr>
<tr>
<td>Tax paid by the employer on non monetary perquisites</td>
<td>10(CC)</td>
</tr>
<tr>
<td>Payment received under a Life Insurance Policy</td>
<td>10(10D)</td>
</tr>
<tr>
<td>Payment from Statutory Provident Fund</td>
<td>10(11)</td>
</tr>
<tr>
<td>Payment from a Recognised Provident Fund</td>
<td>10(12)</td>
</tr>
<tr>
<td>Payment from an Approved Superannuation Fund</td>
<td>10(13)</td>
</tr>
<tr>
<td>House Rent Allowance</td>
<td>10(13A)</td>
</tr>
<tr>
<td>Special Allowance</td>
<td>10(14)</td>
</tr>
<tr>
<td>Exchange Risk Premium received by a Public Financial Institution</td>
<td>10(14A)</td>
</tr>
<tr>
<td>Interest from certain Investments</td>
<td>10(15)</td>
</tr>
<tr>
<td>Lease rent for leasing of an aircraft</td>
<td>10(15A)</td>
</tr>
<tr>
<td>Scholarships</td>
<td>10(16)</td>
</tr>
<tr>
<td>Daily Allowances of MPs and MLA’s</td>
<td>10(17)</td>
</tr>
<tr>
<td>Awards/Rewards</td>
<td>10(17A)</td>
</tr>
<tr>
<td>Pension</td>
<td>10(18)</td>
</tr>
<tr>
<td>Family Pension</td>
<td>10(19)</td>
</tr>
<tr>
<td>Annual Value of Palace of a Ruler</td>
<td>10(19A)</td>
</tr>
<tr>
<td>Income of Local Authorities</td>
<td>10(20)</td>
</tr>
<tr>
<td>Income of Research Associations</td>
<td>10(21)</td>
</tr>
<tr>
<td>Income of News Agency</td>
<td>10(22B)</td>
</tr>
<tr>
<td>Income of a Professional Institution</td>
<td>10(23A)</td>
</tr>
<tr>
<td>Income of a Regimental Fund or Non-Public Fund</td>
<td>10(23AA)</td>
</tr>
<tr>
<td>Exemption to fund established for welfare of employees (Section 23AAA)</td>
<td></td>
</tr>
<tr>
<td>Pension fund of LIC</td>
<td>10(23AAB)</td>
</tr>
<tr>
<td>Income of an Institution established for promoting Khadi and Village Industries</td>
<td>10(23B)</td>
</tr>
<tr>
<td>Income of Khadi and Village Industries Board established by a State Act</td>
<td>10(23BB)</td>
</tr>
<tr>
<td>Income of Statutory Authority Administering Charitable Trust etc.</td>
<td>10(23BBA)</td>
</tr>
<tr>
<td>Income of European Economic Community</td>
<td>10(23BBB)</td>
</tr>
<tr>
<td>Income of SAARC Fund</td>
<td>10(23BBC)</td>
</tr>
<tr>
<td>Income of ASOSAI-SECRETARIAT</td>
<td>10(23BBD)</td>
</tr>
<tr>
<td>Income of IRDA</td>
<td>10(23BBE)</td>
</tr>
<tr>
<td>Any Income Received by any Person on behalf of certain Persons</td>
<td>10(23C)</td>
</tr>
</tbody>
</table>
• Income of a Mutual Fund [Section 10(23D)]
• Income of Investor Protection Fund (Section 23EA)
• Income of Credit Guarantee Fund Trust for SSI [Section 10(23EB)]
• Income of Venture Capital Company (Section 23FB)
• Income of a Registered Trade Union [Section 10(24)]
• Income to Trustees of certain Funds [Section 10(25)]
• Exemption to Employees’ State Insurance Fund [Section 10(25A)]
• Income of a Member of a Scheduled Tribe [Section 10(26)]
• Income of a Resident of Ladakh [Section 10(26A)]
• Income of a Corporation Established for Promoting Interest of Scheduled Castes etc. [Section 10(26B)]
• Exemption to National Minorities Development and Finance Corporation [Section 10(26BB)]
• Exemption from Income of a Corporation established for the Welfare and Economic Upliftment of Ex-servicemen being Citizens of India
• Income of Co-operative Societies Promoting the Interest of Members of Scheduled Castes, etc. [Section 10(27)]
• Exemption of Commodity Boards and Authorities from Income-tax [Section 10(29A)]
• Subsidy from the Tea Board [Section 10(30)]
• Subsidy from the Rubber; Coffee; Spices and other Board or authority established under any law and notified by the Central Government [Section 10(31)]
• Income of minor child [Section 10(32)]
• Income from transfer of units of UTI [Section 10(33)]
• Any income by way of dividends referred to in Section 115-O [Section 10(34)]
• Income from Mutual Funds and certain units [Section 10(35)]
• Transfer of Specified Equity Shares [Section 10(36)]
• Income from Transfer of Agricultural Land [Section 10(37)]
• Income from Transfer of certain equity, units etc. [Section 10(38)]
• Income from international sporting events [Section 10(39)]
• Income from subsidiary company [Section 10(40)]
• Income from transfer of a capital asset [Section 10(41)]
• Specified income to a body or authority [Section 10(42)]
• Income to an Individual by way Reverse Mortgage [Section 10(43)]
• New Pension System Trust [Section 10(44)]
• Allowance or Perquisite to the chairman of UPSC [Section 10(45)]
• Income arising to a Body, Authority or Board or Trust or Commission [Section 10(46)]
• Income of an Infrastructure Debt Fund [Section 10(47)]
PART II

INCOME OF SPECIFIC INDUSTRY

- Complete tax holiday for industrial units situated in free trade zones (Section 10A)
- Special provisions in respect of newly established Units in Special Economic Zone (Section 10AA)
- Special provision in respect of newly established 100% export oriented undertakings (Section 10B)
- Meaning of computer programmes in certain cases
- Special provision in respect of certain industrial undertakings in North-Eastern region (Section 10C)

PART III

TAX EXEMPTIONS FOR CHARITABLE TRUSTS AND INSTITUTIONS

- Meaning of certain terms
- Income not to be included in the Total Income
- Capital Gains [Section 11(1A)]
- Accumulations of Income [Section 11(2)]
- Forms and Modes of Investment [Section 11(5)]
- Income from Voluntary Contributions (Section 12)
- Income to be included in Total Income [Section 13(1)]
- Conditions as to Registration of Trusts, etc. (Section 12A)

PART IV

INCOME OF POLITICAL PARTY AND ELECTORAL TRUST

- Tax Exemptions to Political Parties (Section 13A)
- Voluntary contributions received by an Electoral Trust (Section 13B)

4.1 SECTION 10

Under Section 10 of the Income-tax Act, various items of income are totally exempt from income-tax. In other words, these incomes are not included in the total income of an assessee for income-tax purposes. The exemptions are of the following nature:

(i) exemptions based upon the nature of the income;
(ii) exemptions based upon the status of the assessee; and
(iii) exemptions based upon the source from which the income is derived.

I. INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME OF ANY PERSON

Section 10 provides that in computing the total income of a previous year of any person, any income falling within any of the clauses of the section shall not be included in the total income, provided the assessee proves that a particular item of income is exempt and falls within a particular clause. The onus is on the assessee i.e. the assessee has to prove that his income falls under Section 10. [C.I.T. v. Ramakrishna Deo (1959) 35 I.T.R. 312 (S.C.).]
The items of ‘exemptions’ specified in Section 10, are explained in the following paragraphs:

4.2 AGRICULTURAL INCOME [SECTION 10(1)]

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

Under the Constitution only the State Governments are empowered to levy tax on agricultural income. Hence, the Central Government while imposing income-tax on incomes of various types has specifically excluded agricultural income from the purview of Central income-tax. This exemption would, however, be available only in cases where the income in question constitutes agricultural income within the meaning of Section 2(1A). A detailed discussion is given in Lesson 7.

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

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

This exemption is, however, subject to the provisions of Section 64(2), where the income from self acquired assets which are converted into property of the H.U.F. are to be clubbed with the income of the person who makes the conversion subject to certain conditions. For the purpose of this exemption, it is immaterial whether the H.U.F. has been subject to tax in respect of the income. It is also immaterial whether the member who has received the share of income from the family is a coparcener or not but he must be a member of that family at the time of receiving the money.

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

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

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

(i) In the case of non-residents any income from interest on such securities or bonds as the Central Government may by notification in the Official Gazette specify in this behalf including income by way of premium on the redemption of such bonds.

(ii) In the case of an individual, any income by way of interest on moneys standing
to his credit in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1973 and the Rules made thereunder.

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

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

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

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

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

For the purpose of this clause “family” means:

(i) the spouse and children of the individual; and

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

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

(a) on leave to any place in India;

(b) to any place in India after retirement from service or after the termination of his service

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

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

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

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

1. For journey performed by air, air economy fare of the national carrier (Indian Airlines or Air India) by the shortest route to the place of destination.

2. Where place of origin of journey and destination are connected by rail and the journey is performed by any mode of transport other than by air, air-conditioned first class rail fare by the shortest route to the place of destination.

3. Where place of origin of journey and destination or part thereof are not connected by rail, the maximum amount shall be:
   
   (i) where a recognised public transport system exists, the first class or deluxe class fare on such transport by the shortest route to the place of destination.

   (ii) where no recognised public transport system exists, the air-conditioned first class rail fare, for the distance of the journey by the shortest route as if the journey has been performed by rail.

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

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

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

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

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

(a) The foreign enterprise is not engaged in any trade or business in India.

(b) The total period of stay of the individual in India during the previous year does not exceed 90 days.

(c) Such remuneration is not liable to be deducted from the income of the employer chargeable to tax in India under the Income-tax Act.

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

**(iv) Remuneration of employee of foreign Government during his training in India [Section 10(6)(xi)]:** The remuneration received by an individual being a foreign citizen as an employee of the government of a foreign State during his stay in India in connection with his training in any establishment or office of, or in any undertaking owned by:

(a) The government; or

(b) Any company in which the entire paid-up capital is held by the Central Government, or any State Government or Governments; or partly by the Central Government and partly by one or more State Governments; or

(c) Any company which is a subsidiary of a company referred to in (b); or

(d) Any corporation established by or under a Central, State or Provincial Act; or

(e) Any society registered under the Societies Registration Act, 1860, or under any other corresponding law for the time being in force and wholly financed by the Central Government, or any State Government or partly by the Central Government and partly by one or more State Governments.

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

Under clause (6A), where income is derived by a foreign company by way of royalty or fees for technical services received from government or an Indian concern in pursuance of an agreement made by the foreign company with government or Indian concern after March 31, 1976 which is approved by the Central Government or

* Sub-clause (iii) to (v) omitted by the Finance Act, 1988, w.e.f. 1.4.1989.
where the agreement relates to matter included in the industrial policy of the government for the time being in force and tax on such income is payable, under the terms of such agreement by the government or the Indian concern to the Central Government, the tax so paid will not be included in computing the total income of the foreign company. This exemption is not available under Section 10(6A) if the agreement is entered into on or after 1.6.2002, as amended by Finance Act, 2002. In other words, the exemption is available for the agreements entered into up to 31.5.2002 only.

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

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

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

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

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

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

4.13 ALLOWANCE PAYABLE OUTSIDE INDIA [SECTION 10(7)]

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

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

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

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

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

For the purposes of this clause —consultant" means:

(i) any individual who is either not a citizen of India, or being a citizen of India, is not ordinarily resident in India; or

(ii) any other person being a non-resident engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project provided the technical assistance is in accordance with an agreement entered into by the Central Government and the agency and that the agreement relating to the engagement of the consultant is approved by the prescribed authority for the purposes of this clause.

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

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

(a) the remuneration received by him directly or indirectly, for such duties from any consultant referred to above [i.e. in Section 10(8A)] and

(b) any other income of such individual which accrues or arises outside India, and is not deemed to accrue or arise in India,

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

(i) the individual is an employee of the consultant as defined in Section 10(8A) and is either not a citizen of India or, being a citizen of India is not ordinarily resident in India, and

(ii) the contract of service of such individual is approved by the prescribed authority before the commencement of his service.
4.17 INCOME OF ANY MEMBER OF THE FAMILY [SECTION 10(9)]

The income of any member of the family of any such individual referred to in the preceding paragraphs (14, 15 or 16) accompanying him to India which accrues or arises outside India and is not deemed to accrue or arise in India, is also exempt from tax provided that the member is required to pay any income-tax or social security tax to the Government of that foreign State on such income or as the case may be to the country of origin of such member.

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

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

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

The payment of gratuity by the Life Insurance Corporation of India under the Staff Regulations is wholly exempt from tax under Section 10(10), as the object and purpose of the gratuity scheme of the Life Insurance Corporation of India and the Revised Pension Rules of the Central Government are the same [C.I.T. v. B. Gopalkrishna Murthy (1971) 79 ITR 333 (A.P.)].

(b) The amount of any gratuity received under The Payment of Gratuity Act, 1972, is exempt to the extent it does not exceed an amount calculated in accordance with the provisions of Sub-sections (2) and (3) of Section 4 of the Act. The provisions of The Payment of Gratuity Act in this connection are as under:

   (i) It shall be exempt from tax to the extent of least of: (i) fifteen days' wages (seven days' wages in case of seasonal establishments) for each completed year of service or part thereof in excess of six months on the basis of salary last drawn for every completed year of service or part thereof in excess of six months; or (ii) the gratuity actually received; or (iii) Rs. 10,00,000 (limit raised by notification no.43/2010 dt.11-06-2010)

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

Where the gratuity is paid under The Payment of Gratuity Act, 1972 but the amount exceeds the limit mentioned under (i) above, the excess amount will be taxable.

Note: The Supreme Court has held that wages of fifteen days or seven days, as the case may be, will be calculated by dividing the wages last drawn by 26, i.e. maximum number of working days in a month [Digvijay Woollen Mills Ltd. v. Mahendra Prataparai Buch (1980) 4 Taxman 15].
(c) The amount of any other gratuity received: (i) by the employee from a private employer on his retirement or at the termination of his employment or on his becoming incapacitated or (ii) received by the employee’s nominee on the former’s death, to the extent it does not, in either case, exceed one-half month’s salary for each year of completed service, calculated on the basis of the average salary for the ten months immediately preceding the month in which any such event occurs is exempt subject to a maximum of ten lakhs rupees* or gratuity actually received, whichever is less. Where gratuities are received by the employee from more than one employer in the same previous year, the aggregate amount exempt from income-tax under (c) shall not exceed ₹10,00,000.*

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

Explanation: ‘Salary’ includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites. Where an employee receives dearness pay, it shall be included in the salary.

The Supreme Court has held that if under the terms of employment, commission is payable at a fixed percentage of turnover achieved by the employee such commission would partake of the character of ‘Salary’ [Gestetner Duplicators (P) Ltd. v. C.I.T. (1979) 117 ITR 1 (S.C.)].

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

Illustration:

(a) Mr. A, an employee of the Central Government, receives ₹ 1,00,000 as gratuity at the time of his retirement on May 1, 2011 under the new pension code. Determine the taxability of the gratuity in his hands for the assessment year 2012-13. In case he joins a private sector company on July 1, 2011 as its Managing Director, will it make any difference?

(b) Mr. B is employed in a non-seasonal factory at a salary of ₹ 2,400 P.M. Besides, he also gets dearness allowance @ ₹ 600 P.M. and bonus @ ₹ 200 P.M. He retires on December 31, 2011 and gets ₹ 75,000 as gratuity under the Payment of Gratuity Act after serving 31 years and 4 months in that factory. Compute the amount of gratuity which is exempt under the Income-tax Act, 1961.

(c) Mr. C, who is not covered by the Payment of Gratuity Act, received a gratuity of ₹ 90,000 on retirement on December 31, 2011 after serving 35 years and 8 months. His last drawn emoluments were:

- Basic salary ₹ 4,000 P.M.
- Dearness allowance ₹ 1,000 P.M.

---

* The limit has been raised to Rs. 10,00,000 vide Notification No. 43/2010 dated 11.06.10 for employees who retire/die on or after 24.05.10. Earlier, the limit was Rs. 3,50,000.
Annual increment of ₹200 P.M. falls due on 1st October each year. Determine the amount of gratuity exempt from tax for the assessment year 2012-13.

**Solution:**

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

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

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

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

(i) ₹53,654 (being 15 days' salary for each completed year of service i.e. ₹1,730.77 × 31);

(ii) ₹10,00,000; or

(iii) ₹75,000 (being gratuity actually received).

Hence, ₹53,654 being the least, is exempt from tax and the balance ₹21,346 is taxable for the assessment year 2012-13.

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

Average salary shall be computed as under:

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

(i) February 1, 2010 to September 30, 2010 @ ₹4,800

(i.e. ₹3,800 + 1,000) × 8 months = ₹38,400

(ii) October 1, 2010 to November 30, 2010 @ ₹5,000

(i.e. ₹4,000 + 1,000) × 2 months = ₹10,000

Total salary for 10 months = 48,400

Average salary p.m. = ₹48,400 ÷ 10 = ₹4,840

Hence 1/2 month's average salary = ₹4,840 ÷ 2

= ₹2,420 p.m.

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

(i) ₹84,700 (being 1/2 month’s salary for each completed year of service i.e. ₹2,420 × 35);

(ii) ₹10,00,000; or

(iii) ₹90,000 (being gratuity actually received).

Hence, ₹84,700 being the least is exempt from tax and is not taxable for the assessment year 2012-13.
4.19 COMMUTATION OF PENSION [SECTION 10(10A)]

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

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

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

(a) in cases where the employee receives any gratuity; the commuted value of 1/3rd of pension which he is normally entitled to receive;

(b) in any other case, the commuted value of 1/2 of such pension.

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

Illustration:

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

(a) he receives ₹ 20,000 as gratuity

(b) he does not receive gratuity.

Solution:

<table>
<thead>
<tr>
<th></th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commuted value of 3/5 of pension</td>
<td>36,000</td>
</tr>
<tr>
<td>Commuted value of full pension i.e. ( \left( \frac{5}{3} \times 36,000 \right) )</td>
<td>60,000</td>
</tr>
</tbody>
</table>

(a) If Mr. A receives gratuity:

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

\[ = \frac{1}{3} \times 60,000 = ₹ 20,000 \]

Committed pension chargeable to tax as salary

\[ = ₹ (36,000 - 20,000) = ₹ 16,000 \]

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

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

\[ = \frac{1}{2} \times 60,000 = ₹ 30,000 \]

Committed pension chargeable to tax as salary

\[ = ₹ (36,000 - 30,000) = ₹ 6,000 \]
(iv) Any payment in commutation of pension received from a pension fund set up by the Life Insurance Corporation of India in terms of Section 10(23AAB) is fully exempt from tax.

4.20 ENCASHEMENT OF EARNED LEAVE [SECTION 10(10AA)]

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

(i) Any payment received by an employee of the Central Government or a State Government as the cash equivalent of leave salary in respect of the period of earned leave at the employee’s credit only at the time of retirement whether such retirement is on superannuation or otherwise. The effect of this clause is that payments received by an employee in respect of any period of leave not availed by him would be chargeable to tax except, when such payments are made at retirement and qualify for exemption under Section 10(10AA) of the Act.

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

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

(i) Cash equivalent of the leave salary in respect of the period of earned leave standing to the credit of employee at the time of retirement/superannuation (maximum earned leave entitlement being: 30 days for every year of actual service rendered for the employer from whose service he has retired); or

(ii) 10 month’s “average salary”, i.e. salary drawn during the period of 10 months immediately preceding the retirement/superannuation, or

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

(iii) The amount specified by the Government. The maximum amount which is not chargeable to tax under Section 10(10AA)(ii) of the Act, as specified by the Government is given below:

<table>
<thead>
<tr>
<th>Date of Retirement</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(whether superannuation or otherwise)</td>
<td></td>
</tr>
<tr>
<td>Between January 1, 1988 and March 31, 1995</td>
<td>79,920</td>
</tr>
<tr>
<td>Between April 1, 1995 and June 30, 1995</td>
<td>1,30,320</td>
</tr>
<tr>
<td>Between July 1, 1995 and July 1, 1997</td>
<td>1,35,360</td>
</tr>
<tr>
<td>Between July 2, 1997 and April 1, 1998</td>
<td>2,40,000</td>
</tr>
<tr>
<td>After April 1, 1998</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>
(iv) The amount of leave encashment actually received at the time of retirement.

*Illustration:*

Mr. P, an employee of a company, receives ₹ 7,75,000 as leave salary at the time of his retirement on December 31, 2011. Determine the amount of taxable leave salary for the assessment year 2012-13 from the following information:

<table>
<thead>
<tr>
<th>Salary at the time of retirement</th>
<th>₹ 25,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average salary received during last 10 months:</td>
<td></td>
</tr>
<tr>
<td>— From March 1, 2011 to September 30, 2011</td>
<td>₹ 24,000</td>
</tr>
<tr>
<td>— From October 1, 2011 to December 31, 2011</td>
<td>₹ 25,000</td>
</tr>
<tr>
<td>Duration of Service</td>
<td>26 years</td>
</tr>
<tr>
<td>Leave entitlement for each year of service</td>
<td>1⅝ months</td>
</tr>
<tr>
<td>Leave availed while in service</td>
<td>8 months</td>
</tr>
<tr>
<td>Leave at the credit of employee at the time of retirement</td>
<td>31 months</td>
</tr>
</tbody>
</table>

\[
(26 \times 1 \frac{1}{2} - 8) = \frac{26}{2} - 8 = 18
\]

| Leave salary paid at the time of retirement (i.e. ₹ 25,000 \times 31) | ₹ 7,75,000 |

*Solution:*

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

- Leave entitlement @ one months leave for every year of service 26 months
- Leave availed while in service 8 months
- Leave standing to the credit of the employee at the time of retirement 18 months
- Average salary of last 10 months ending on December 31, 2010 [i.e. ₹ (24,000 x 7 + ₹ 25,000 x 3) ÷ 10] 24,300

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

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

Hence, ₹ 2,43,000, being the least, shall be exempt from tax under Section 10(10AA) of the Act and the balance ₹ 5,32,000 (i.e. ₹ 7,75,000 – 2,43,000) shall be taxable for the assessment year 2012-13.
4.21 RETRENCHMENT COMPENSATION [SECTION 10(10B)]

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

(i) Actual amount received.
(ii) Amount specified by Central Government which should not be less than ₹ 50,000. This amount of ₹ 50,000 has been raised to ₹ 5,00,000 if payment is made on or after 1.1.1997 (Notification No. 10969 dated 25.6.99).
(iii) An amount calculated in accordance with the provisions of clause (b) of Section 25F of the Industrial Disputes Act, 1947.

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

Section 25F(b) of the Industrial Disputes Act provides for payment of retrenchment compensation equivalent to 15 days average pay for every completed year of continuous service or any part thereof in excess of six months.

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

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

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

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

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

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

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

According to Section 10(CC), in the case of an employee, being an individual deriving income in the nature of a perquisite, not provided for by way of monetary payment within the meaning of clause (2) of Section 17, the tax on such income actually paid by his employer, on behalf of such employee, notwithstanding anything contained in Section 200 of the Companies Act, 1956, shall exempt.

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

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

(a) any sum received under Sub-section (3) of Section 80DD or Sub-section (3) of Section 80DDA; or

(b) any sum received under a Keyman insurance policy; or

(c) any sum received under an insurance policy issued on or after the 1st day of April, 2003 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured:

Provided that the provisions of this sub-clause shall not apply to any sum received on the death of a person:

Provided further that for the purpose of calculating the actual capital sum assured under this sub-clause, effect shall be given to the Explanation to Sub-section (3) of Section 80C or the Explanation to Sub-section (2A) of Section 88, as the case may be.
"Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person.

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

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

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

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

(i) The employee has rendered continuous service with his employer for a period of 5 years or more; or

(ii) Where he has not rendered such continuous service, the service has been terminated by reason of employee's ill-health or by the contraction or discontinuance of the employer's business or by any other cause beyond the control of the employee; or

(iii) On cessation of his employment he obtains employment with any other employer and the balance standing in his Recognised Provident Fund is transferred to his account in a Recognised Provident Fund maintained by the new employer.

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

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

Any payment from an approved superannuation fund made:

(i) on the death of the beneficiary; or

(ii) to an employee in lieu of or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or

(iii) by way of refund of contributions on the death of the beneficiary; or

(iv) by way of refund of contributions to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or at his becoming incapacitated from service prior to such retirement to the extent to which such payment does not exceed the contributions made prior to the commencement of this Act, i.e., 1.4.1962, and also any interest thereon, would be wholly exempt from tax.
4.29 HOUSE RENT ALLOWANCE [SECTION 10(13A)]

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

(i) Actual amount of such allowance received in respect of the relevant period;

(ii) Rent paid over 10% of salary [Rent paid – 10% of salary]

(iii) an amount equal to:

(a) where such accommodation is situated at Mumbai, Kolkatta, Delhi or Chennai, one-half of the amount of salary due to the assessee in respect of the relevant period; and

(b) where such accommodation is situated at any other place, two-fifth of the amount of salary due to the assessee in respect of the relevant period.

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

Explanation:

(i) ‘Relevant period’ means the periods during which the said accommodation was occupied by the assessee during the previous year.

(ii) ‘Salary’ includes Basic pay, dearness allowance, if the terms allow, includes commission, but excludes all other allowances and perquisites. However, the Supreme Court has held that commission to be paid to an employee at fixed percentage of turnover earned by him as salary. [Gestetner Duplicators (P) Ltd. v. C.I.T. (1979) 117 I.T.R. 1].

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

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

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

Illustration:

Mr. G who lives in Lucknow, gets the following emoluments during the previous year ended on March 31, 2012.

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

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

One month salary due from Y Ltd. during 2010-11 is received by him in April 2011. He pays ₹ 3,000 per month as house rent throughout the previous year. Determine the amount of house rent allowance chargeable to tax for the assessment year 2012-13.

Solution:

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

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

₹ 1,000 per month, being the least shall be exempt from tax.

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic salary per month</td>
<td>₹ 6,000</td>
</tr>
<tr>
<td>Commission of one month (i.e. 2% of ₹ 10,00,000 ÷ 2)</td>
<td>₹ 10,000</td>
</tr>
<tr>
<td>Total</td>
<td>₹ 16,000</td>
</tr>
</tbody>
</table>

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

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

₹ 1,400 per month, being the least shall be exempt from tax.

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>X Ltd. (₹ 1,000 – 1,000) × 10</td>
<td>NIL</td>
</tr>
<tr>
<td>Y Ltd. (₹ 2,500 – 1,400) × 2</td>
<td>2,200</td>
</tr>
<tr>
<td>Total</td>
<td>2,200</td>
</tr>
</tbody>
</table>
4.30 SPECIAL ALLOWANCE [SECTION 10(14)]

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

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

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

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

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

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

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

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

Provided that free conveyance is not provided by the employer;

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

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

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

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

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

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Name of allowance</th>
<th>Place at which allowance is exempt</th>
<th>Extent to which allowance is exempt</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Any special compensate allowance in the nature of composite hill compensatory allowance or high altitude allowance or uncongenial climate allowance or snow bound area allowance or avalanche allowance</td>
<td>I. (a) Manipur Mollan/RH-2365</td>
<td>₹800 per month</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(b) Arunachal Pradesh</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(i) Kameng</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(ii) North Eastern Arunachal Pradesh where heights are 9,000 ft. and above</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(iii) Areas east or west of Siang and Subansiri sectors</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(c) Sikkim</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(i) Area North-NE-East of line Chhaten LR 0105, Launchung LR 1902, pt. 4326 LW 1790, pt. 4349 LW 1479, pt. 3601 LW 1471 to mile 13 LW 1367 to Berluk LW 2253</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(ii) All other areas at 9,000 ft. and above.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(d) Uttar Pradesh Areas of Harsil, Mana and Malari Sub-divisions and other areas of</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>heights at 9,000 ft. and above.</td>
<td></td>
</tr>
<tr>
<td>(e) Himachal Pradesh</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) All areas at 9,000 ft. and above ahead of line joining puhkaja-kunzomla towards the bower</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Area ahead of line joining Karchham and Shigrila towards the bower</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) All areas in Kalpa, Spiti, Lahul and Tisa</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f) Jammu and Kashmir</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) All areas from NR 396950 to NR 350850, NR 370790, NR 311776 North of Shaikhra Village, North of Pindi Village to NR 240800</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Areas of Doda, Sank and other posts located in areas at a height of 9,000 ft. and above</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) North of line Kud-Dudu and Basttgarh, Bilwar, Batote and Patnitop</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) All areas ahead of Zojila served by Road Srinagar - Zojila-Leh in Leh District Gulmarg - All areas forward of line joining anita Linyan 3309 - Kaunrali 2407.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
</tr>
<tr>
<td>(vi) Uri South - All areas forward of Kaunrali – Kandi 1810 Kustam 1505 – Sebasantra 1006 Changez 0507 – Jak 19904 Keekar 9704 Jamun 9607 Neeta 9508</td>
<td>(vii) BAAZ Kaiyan Bowl – All areas forward of Dulurja 9712 – BAAZ 0317 – Shamsher 0416 including New Shamsher 0615 – Zorawar 1017 – Malaugan Base 1027 - Radha 0836 to Nastachun Pass 9847</td>
<td>(viii) Tangdhar - All areas west of Nastachun Pass Tangdhar Bowl and on Shamshabari Range and forward of it Karan and Machhal sub-sectors - All areas along the line Pharkiangali 0869 to z Gali 4376 and forward of Shamshabari Range. Panzgam, Trehgam and Drugmul.</td>
<td>₹7,000 Per month</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>₹300 per month</td>
</tr>
</tbody>
</table>

II. Siachen areas of Jammu and Kashmir.

III. All places located at a height of 1,000 metres or more above the sea level, other
2. Any Special Compensatory Allowance in the Nature of Border Area Allowance, Remote Locality Allowance or Difficult Area Allowance or Disturbed Area Allowance

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>I. (a) Little Andaman, Nicobar and Narcondum Islands.</td>
<td>₹1,300</td>
<td>Per month</td>
<td></td>
</tr>
<tr>
<td>(b) North and Middle Andamans.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) Throughout Lakshadweep and Minicoy Islands.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| (d) All places on or north of the following demarcation line:  
Point 14600 (2881) to Sala MS 2686 – Matau MS 6777 - Sakong MT 1379 - Bamong-Khonawa MO 2803 – Nyapin MO 7525 – River Khru to its junction with the river Kaml MP 2226 - Taliha - Yapui MK 7410 - Gshong MK 9749 Yinki Yong NF 4324 – Damoroh MF 6208 – Ahinkolin NF 8811 – Kronli MG 2407 – Hanili NM 4096 – Gurongon NM 4592 - Loon NM 7579 - Mayu-liang NM 0169 - Chawah NM 9943 Kamphu NM 1125 - Point 6490 (NM 1493) Vijaynagar NSA 486. |   |   |   |
| (e) Following areas in Himachal Pradesh:  
(i) Pangi Sub-Division of Chamba district  
(ii) Following Panchayats and villages of Bharmaur |   |   |   |
<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tehsil of Chamba District:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(A) Panchayat: Badgaun, Bajol, Deol Kugti Nayagam and Tundah.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(B) Villages: Ghatu of Gram Panchayat Jagat Kanarsi of Gram Panchayat Cauhata.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Lahul and Spiti District.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Kinnaur District:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(A) Asrang, Chitkul and Hango Kuno Charang Panchayats</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(B) 15/20 Area comprising the Gram Panchayats of Chhota Khamba, Nathpa and Rupi.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(C) Pooh Sub-Division excluding the Panchayat Area specified above.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(v) 15/20 Area of Rampur Tehsil comprising of Panchayats of Koot, Labana-Sadana, Sarpara and Chandi Branda of Shimla District.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vi) 15/20 Area of Nirmand Tehsil, comprising the Gram Panchayats of Kharga, Kushwar and Sarga of Kullu District.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f) Chimptuipui district of Mizoram and areas beyond 25 km. from Lunglei town in Lunglei District of Mizoram.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g) Following areas in Jammu and Kashmir –</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Niabat Bani, Lohi, Malhar and Macch-odi of Kathua District.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Dudu Basantgarh, Lander Bhamag Ilaqa, Thakrakote and Nagote of Udhampur District.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(iii) All areas in Tehsil Mahore except those specified at III(f)(i) below in Udhampur District.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(iv) Ilqaqs of Padder and Niabat Nowgaon in Kishtwar Tehsil of Doda District.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(v) Leh District.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(vi) Entire Gurez-Nirabat, Tangdar Sub-division and Keran Ilqaq of Baramulla District.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(h) Following areas of Uttar Pradesh</td>
<td>₹1,100 per month</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(i) Chamoli District</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(ii) Pithoragarh District</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(iii) Uttarkashi District.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(I) Throughout Sikkim State</td>
<td></td>
</tr>
<tr>
<td>II.</td>
<td></td>
<td>Installations in the continental shelf of India and the Exclusive Economic Zone of India.</td>
<td></td>
</tr>
<tr>
<td>III.</td>
<td>(a)</td>
<td>Throughout Arunachal Pradesh other than areas covered by those specified at I(d) above.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(b) Throughout Nagaland State.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(c) South Andaman (including Port Blair).</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(d) Throughout Lunglei District (excluding areas beyond 25 km, from Lunglei town) of Mizoram.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(e) Dharamanagar, Kailasahar, Amarpur and Knowai in Tripura.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(f) Following areas in Jammu and Kashmir:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(i) Areas up to Goel from Kamban side and areas up</td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>to Arnas from Keasi side in Tehsil Mahore of Udhampur District.</td>
<td>(ii) Matchill in Baramulla District.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g) Following areas in Himachal Pradesh:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Bharmour Tehsil, excluding Panchayats and villages covered by those specified at (e)(ii) above of Chamba District.</td>
<td>(ii) Chhota Bhangal and Bara Bhangal area of Kangra District;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Kinnaur District other than areas specified at (e)(iv)</td>
<td>(iii) Following Areas of Mandi District:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Dodra - Kawar Tehsil, Gram Panchayats of Darkali in Rampur, Kashapath Tehsil and Munish, Ghori Chaibis of Pargana Sarhan of Shimla District.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV. (a) Throughout Aizawal District of Mizoram.</td>
<td>(b) Throughout Tripura except areas those specified at III(e).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) Throughout Manipur.</td>
<td>(d) Following areas of Himachal Pradesh:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Jhandru Panchayat in Bhatiyat Tehsil, Churah Tehsil, Dal-housie Town (including Banikhet proper) of Chamba District.</td>
<td>(ii) Outer Seraj (excluding Village of Jakat-khana and Burow in Nirmand Tehsil of Kullu District.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Following Areas of Mandi District:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>₹1,050 per month</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
(1) Chhuar Valley (Jogindernagar Tehsil)
(B) Bagara, Chhatri, Chhotdhar, Gara-gushain, Gatoor, Gharyas, Janjheli, Jaryar, Johar Kalhani Kalwan, Kholanal, Loth, Silibagi, Somachan, Thachd-har, Tachi and Thana Panchayats of Thunag Tehsil
(C) Binga, Kamlah, Saklana, Tanyar and Tarakholah, Panchayats of Dharampur Block.
(D) Balidhar, Bagra, Gopalpur, Khajol, Mahog, Mehudi, Manj, Pekhi, Sainj, Sarahan and Teban, Panchayats of Karsog Tehsil.
(E) Bohi, Batwara, Dhanyara, Paura-Kothi, Seri and Shojaa, Panchayats of Sundernagar Tehsil.

(iv) Following areas and offices of Kangra District:
(A) Dharamsala town and Women's ITI, Dari, Mechanical Workshop, Ramnagar, Child Welfare and Town Country Planning Offices. Sakoh; CRSF Office at lower Sakoh; Kangra Milk Supply Scheme, Shamnagar; Tea Factory, Dari; Forest Corporation Office, Shamnagar; Tea Factory, Dari; Settlement Office, Shamnagar and Binwa Project, Shamnagar, Offices located outside the Municipal limit of Dharamshala town but including in Dharamsala town for purposes of

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>₹ 750 per month</td>
</tr>
</tbody>
</table>
eligibility to special
Compensatory (Remote
Locality) Allowance;

(B) Palampur town, including
HPKVVV Campus at
Palampur and H.P. Krishi
Vishvavidyala Campus;
Cattle Development
Office/Jersy Farm, Banuri;
Serti-culture office/Indo-
German Agriculture
Workshop/ HPPWD
Division, Bundla; Electrical
Sub-Division, Lohna;
D.P.O. Corporation, Bundla
and Electrical HPSEE
Division, Ghuggar offices
located out-side the
municipal limits of
Palampur town but included
in Palampur town for the
purpose of above
allowance.

(v) Chopal Tehsil; Ghoris,
Panjgaon, Patsnu, Naubis
and Teen Koti of Pargana
Sarahan; Deothi Gram
Panchayat of Taklesh
Area; Pargana Barabis;
Kasba Rampur and Ghori
Nog of Pargana Rampur of
Rampur Tehsil of Shimla
District and Shimla Town
and its sub-urbs (Dhalli,
Jatog, Kasumpti,
Mashobra, Taradevi and
Tutu)

(vi) Panchayats of Bani,
Bakhali (Panchhad Tehsil),
Bharog Bheneri (Paonata
Tehsil), Birla (Nahan
Tehsil), Dibber (Pachhad
Tehsil) of Thanan Kasoga
(Naham Tehsil) in Sirmour
District and Thansgiri Tract
of Sirmour District.
(vii) Mangal Panchayat of Solan District.

(e) Following areas in Jammu and Kashmir:

(i) Areas in Poonch and Rajouri Districts excluding the towns of Poonch and Rajouri and Sunderbani and other urban areas in the two Districts.

(f) Following area in Jammu and Kashmir: Areas not included in I(g), III(f) and IV(e) above, but which are within a distance of 8 km. from the line of actual control or at places which may be declared as qualifying for border allowance from time to time by the State Government for their own staff.

V. Jog Falls in Shimoga District in Karnataka

VI. (a) Throughout the State of Himachal Pradesh other than areas covered by those specified in I(e), III(g) and IV(d)

(b) Throughout the State of Assam and Meghalaya

3. Tribal area allowance

(a) Madhya Pradesh

(b) Tamil Nadu

(c) Uttar Pradesh

(d) Karnataka

(e) Tripura

(f) Assam

(g) West Bengal

(h) Bihar

(i) Orissa

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(vii) Mangal Panchayat of Solan District.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e) Following areas in Jammu and Kashmir:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Areas in Poonch and Rajouri Districts excluding the towns of Poonch and Rajouri and Sunderbani and other urban areas in the two Districts.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f) Following area in Jammu and Kashmir: Areas not included in I(g), III(f) and IV(e) above, but which are within a distance of 8 km. from the line of actual control or at places which may be declared as qualifying for border allowance from time to time by the State Government for their own staff.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>V. Jog Falls in Shimoga District in Karnataka</td>
<td>₹300 per month</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VI. (a) Throughout the State of Himachal Pradesh other than areas covered by those specified in I(e), III(g) and IV(d)</td>
<td>₹200 per month</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Throughout the State of Assam and Meghalaya</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Tribal area allowance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Madhya Pradesh</td>
<td>₹200 per month</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Tamil Nadu</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) Uttar Pradesh</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(d) Karnataka</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e) Tripura</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f) Assam</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g) West Bengal</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(h) Bihar</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Orissa</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>4.</td>
<td>Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running of such transport from one place to another place, provided that such employee is not in receipt of daily allowance</td>
<td>Whole of India</td>
<td>70 per cent of such allowance upto a maximum of ₹6,000 per month</td>
</tr>
<tr>
<td>5.</td>
<td>Children education allowance</td>
<td>Whole of India</td>
<td>₹100 per month per child up to a maximum of two children</td>
</tr>
<tr>
<td>6.</td>
<td>Any allowance granted to an employee to meet the hostel expenditure on his child</td>
<td>Whole of India</td>
<td>₹300 per month per child up to a maximum of two children</td>
</tr>
</tbody>
</table>
|7. | Compensatory field area allowance | (a) Following Areas in Arunachal Pradesh:  
(i) Tirap and Changlang districts.  
(ii) All areas north of line joining point 4448 in LZ 4179 – Nukme Dong MS 3272 – Sepla MT 2969 – Palin MO 9213 – Daporijo NR 5841 – Along NL 1273 – Hunli NM 3196 - Tidding Tuwi MT 6369 – Hayuliang NN 0170 – Tawaken MT 8136 – Champai Bun NM 8814, all inclusive.  
(b) Throughout Manipur and Nagaland.  
(c) Following areas in Sikkim: | ₹2,600 per month |
<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
</table>
| All area north and north east of line joining Phalut LV 4750 – Gezing LV 7059 - Mangkha LV 6160 - Penlang La LW 0666 - Rangli LW 1448 - BP 1 in LW 2453 on Indo-Bhutan Border, all inclusive. (d) Following areas in Himachal Pradesh: All areas east of line joining Umasila NV 3951 – Udaipur NY 8663 - Manikaran SB 2300 - Pir Parbati Pass TA 1459 - Taranda TA 2335 - Barasua - Pass TA 8801, all inclusive. (e) Following areas in Uttar Pradesh: All areas north and north-east of line joining Barasua Pass Gangnani TG 1362 - Govind Ghat TG 0937 - Tapovan TH 1822 - Musiari TN 8982 - Relagad TO 2466, all inclusive. (f) Following areas in Jammu and Kashmir (i) areas north and east of line joining Zojila Mu 3036 - Baralachala NE 6672 along the Great Himalayan Range, all inclusive. (ii) all areas west of line joining Point 1556 in NR 5470 - Gulmarg MT 3105 - Naushara MY 3105 - Ringapat MT 2133 - Handwara MT 2043 - Laingyal MT 2339 - Point 8405 in NG 4565 - North of line joining point 8403 – Bunakut MT 5453 – Razan NN 2239 - Zojila, all inclusive.
(iii) All areas west of line joining tip of Chicken Neck RD 7073 - Canal Junction RD 6364 – Mawa Brahmana RD 6183 - Chauki RD 6393 – Road junction RD 6499 – Baramgala MY 3854 - Point 1556 in NR 5470, all inclusive.

8. Compensatory modified field area allowance

(a) Following areas in Punjab and Rajasthan: Areas west of line joining Jessai, Barmar, Jaisalmer, Pokharan, Udasar, Mahajan Ranges, Suratgarh, Lalgarh, Jattan, Abohar, Govindgarh, Fazilka, Jandiala Guru, Moga, Dholewal, Deas, Bir Sarangwal, Hussainiwala, Dera Baba Nanak, Laisain pluge upto the international border, all inclusive.

(b) Following areas in Haryana: Satrod (Hissar).

(c) Following areas in Himachal Pradesh: Areas North of line joining Narkhanda, Keylong upto field area line/high altitude line.

(d) Following areas in Arunachal Pradesh and Assam:

(i) Cachar and North Cachar districts of Assam including Silchar.

(ii) all areas of Arunachal Pradesh and Assam north of river Brahmaputra except Tejpur, Misamari and field areas.

(e) Throughout Mizoram and Tripura.

₹1,000 per month
(f) Following areas in Sikkim and West Bengal: Areas northwards of line joining Sevoke LV 9112 – Burdong LV 985 (Sherwani LV 9453 - Bagrakot LW 0113 - Damdim LW 1109 - New Mal Hasimara - QB 7894 Ganga Ram Tea Estate QA 1377 upto the high altitude line/field area line/international border, all inclusive.

(g) Following areas in Uttar Pradesh: Areas north of line joining Uttarkashi, Karan Prayag, Gauchar, Joshimath, Ghamoli, Rudra Prayag, Askote, Charamgad, Dharchula, Kausani and Narendra Nagar upto international border, all inclusive.

(h) Following areas in Jammu and Kashmir:

(i) Areas west of line joining Pattan, Baramulla, Kupwara, Drugmula, Panges, Mankes, Buniyar, Pantha Chowk, Khanabal, Anantnag, Khundru and Khru upto the existing high altitude line, all inclusive.

(ii) Areas west of line joining - BP - 19, Brahmana- di-Bari, Jindra, Dhansal, Katra, Sanjhi Chatt, Batote, Patni Top, Ramban and Banihar upto the existing High altitude line, all inclusive.
<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>9.</td>
<td>Any special allowance in the nature of counter insurgency allowance granted to the member of armed forces opera-ting in areas away from their permanent locations for a period of more than 30 days.</td>
<td>Whole of India</td>
<td>₹ 3,900 per month</td>
</tr>
<tr>
<td>10.</td>
<td>Transport allowance granted to an employee to meet his expenditure for the purpose of computing between the place of his residence and the place of his duty.</td>
<td>Whole of India</td>
<td>₹ 800 per month</td>
</tr>
<tr>
<td>11.</td>
<td>Transport allowance granted to an employee, who is blind or orthopaedically handicapped with disability of lower extremities, to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty.</td>
<td>Whole of India</td>
<td>₹ 1600 p.m.</td>
</tr>
<tr>
<td>12.</td>
<td>Underground allowance</td>
<td>Whole of India</td>
<td>₹ 800 p.m.</td>
</tr>
</tbody>
</table>

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

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

4.31 Interest from certain Investments [Section 10(15)]

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

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

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

(ii) Interest on 7 per cent Capital Investment Bonds in the case of individual and Hindu undivided families specified up to 31-5-2002 only.

(iii) Interest on 9 per cent Relief Bonds, with effect from 1.1.99 (Prior to that it was 10% relief bond), in the case of an individual and Hindu undivided family.

(iv) Interest received by a non-resident Indian from notified bonds (i.e., NRI Bonds, 1988, issued by State Bank of India), NRI Bonds (Second Series) issued by State Bank of India or by an individual owning such bonds by virtue of being a nominee or survivor of such non-resident Indian or by an individual to whom the bonds have been gifted by the non-resident Indian (applicable from the assessment year 1989-90). [Exemption will be available only if the bonds are purchased by a non-resident Indian in foreign exchange. The interest and principal received in respect of such bonds whether on their maturity or otherwise, is not allowable to be taken out of India. Where the individual who is a non-resident Indian in the previous year in which the bonds are acquired, becomes a resident in India in any subsequent year the interest received from such bonds will continue to be exempt in the subsequent years as well].

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

(v) Interest on securities held by the Issue Department of the Central Bank of Ceylon.

(vi) Interest payable to any foreign bank performing central banking functions outside India (This exemption will be available from the assessment year 1985-86 where the interest is payable in respect of the deposits made by such bank with any scheduled bank in India with the approval of the Reserve Bank of India).

(via) Interest payable to European Investment Bank, on a loan granted by it in pursuance of the framework-agreement for financial co-operation entered on the 25th day of November, 1993 by the Central Government with that Bank.
(a) Interest payable by the Government or a local authority on moneys borrowed by it before the 1st day of June, 2001 from, or debts owned by it before the 1st day of June, 2001 to sources outside India.

(b) Interest payable by an industrial undertaking on moneys borrowed by it under a loan agreement entered into before 1st day of June 2001 with any such financial institution in a foreign country as may be approved in this behalf by the Central Government by general or special order. The International Finance Corporation, Washington; Export Import Bank of Washington, Washington, D.C.; Export Import Bank of Japan, Tokyo; The Development Loan Fund, Columbia, U.S.A.; The West German Bank for Reconstruction, West Germany and the Banque Francaise de Commerce Exterieur, Paris.

(c) Interest payable by an industrial undertaking in India on any moneys borrowed or debt incurred by it before the 1st day of June, 2001 in a foreign country in respect of purchase outside India of raw materials, or components, or capital plant and machinery to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan or debt and its repayment. With effect from the assessment year 1983-84, the scope of the exemption is extended to include purchase of capital plant and machinery under hire-purchase agreement or a lease agreement with an option to purchase such plant and machinery.

(d) Interest payable by the Industrial Finance Corporation of India or the Industrial Development Bank of India or the Industrial Credit and Investment Corporation of India, or Export Import Bank of India or the National Housing Bank or the Small Industries Development Bank of India on any moneys borrowed from sources outside India before the 1st day of June, 2001 to the extent such interest does not exceed the interest calculated at the rate approved by Central Government.

(e) Interest payable by any other financial institution established in India or a banking company on any moneys borrowed before the 1st day of June, 2001 from sources outside India under an approved loan agreement to the extent it does not exceed the rate approved by Central Government.

(f) Interest payable by an industrial undertaking in India on any moneys borrowed by it in a foreign currency from sources outside India under an approved loan agreement before the 1st day of June, 2001.

(fa) Interest payable by a schedule bank, to a non-resident or to a person who is not ordinarily resident within the meaning of Section 6 on deposit in foreign currency where acceptance of such deposits by the bank is approved by the Reserve Bank of India.

(g) Interest payable by a public company formed and registered in India, and eligible for deduction under Section 36(1)(viii), with the main objective of carrying on business of providing long-term finance for construction or purchase of houses in India for residential purposes on any moneys borrowed by it in foreign currency from sources outside
India under an approved loan agreement, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government before 1st day of June 2003.

(h) Interest payable by public sector companies on certain specified bonds and debentures subject to such conditions, including the condition that the holder of such bonds or debentures registers his name and his holding with that company, as may be specified by the Central Government by notification in the Official Gazette.

(i) Interest on deposits, with a notified scheme, made by a retiring Government employee (or public sector employee, with effect from the assessment year 1991-92) out of his retirement benefits for a lock-in-period of three years.

Explanation 1: For the purpose of these sub-clauses, the expression "industrial undertaking" means any undertaking which is engaged in -
(a) the manufacture or processing of goods; or
(aa) the manufacture of computer software or recording of programmes on any disc, tape, perforated media or other information device; or
(b) the business of generation or distribution of electricity or any other form of power; or
(ba) the business of providing telecommunication services; or
(c) mining; or
(d) the construction of ships; or
(e) the operation of ships or aircrafts or construction or operation of rail systems.

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

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

(vii) Interest on securities held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal and interest on deposits for the benefit of the victims of the Bhopal gas leak disaster held in such account with the Reserve Bank of India or with a Public Sector Bank, as the Central Government may notify.

(viii) Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

(ix) Interest on bonds -
(a) issued by a local authority; and
(b) specified by the Central Government by notification in the Official Gazette.

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

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

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

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

4.33 Scholarships [Section 10(16)]

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

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

The provisions in this regard are as follows:

Any income by way of:

(i) daily allowance received by any person by reason of his membership of Parliament or of any State legislature or of any Committee thereof;

(ii) any allowance received by any person by reason of his membership of Parliament under the Members of Parliament (Constituency Allowance) Rules, 1986;

(iii) any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislation.

4.35 Awards/Rewards [Section 10(17A)]

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

4.36 Pension [Section 10(18)]

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

**4.37 Family Pension [Section 10(19)]**

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

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

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

**4.39 Income of Local Authorities [Section 10(20)]**

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

**4.40 Income of Research Associations [Section 10(21)]**

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

(i) any assets held by the research association where such assets form part of the corpus of the fund of the association as on the first day of June, 1973;

(ii) any assets (being debentures issued by or on behalf of, any company or corporation) acquired by the research association before the 1st day of March, 1983;

(iii) any accretion to the shares forming part of the corpus of the fund mentioned in sub-clause (i) by way of bonus shares allotted to the research association;

(iv) voluntary contribution received and maintained in the form of jewellery, furniture or any other article as the Board may by notification in the official gazette, specify,
for any period during the previous year otherwise than in the forms and modes as specified in Section 11(5).

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

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

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

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

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

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

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

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

Further, the exemption under this clause shall be withdrawn if Central Government is satisfied that conditions are not being fulfilled.
4.43 Income of a Regimental Fund or Non-Public Fund [Section 10(23AA)]

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

4.44 Exemption to fund established for welfare of employees (Section 23AAA)

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

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

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

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

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

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

Further, the exemption under this clause shall be withdrawn if Central Government is satisfied that conditions are not being fulfilled after giving an opportunity of being heard.
4.47 **Income of Khadi and Village Industries Board established by a State Act [Section 10(23BB)]**

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

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

Any income of any body or authority whether or not body corporate or corporation solely established, constituted or appointed by or under any Central, State or Provincial Act which provides for the administration of any one or more of the following, that is to say, public religious or charitable trusts or endowments (including maths, temples, Gurudwaras, wakfs, churches, synagogues, agiaries or other places of public religious worship) or societies for religious or charitable purposes registered as such under the Societies Registration Act, 1860 or any other law for the time being in force, provided nothing aforesaid shall be construed to exempt from tax the income of any trust, endowment or society referred to therein.

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

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

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

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

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

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

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

4.52 **Income of IRDA [Section 10(23BBE)]**

Any income of Insurance Regulatory and Development Authority established under Section 3(1) of IRDA Act, 1999 shall be exempt from tax from the Assessment Year 2001-02.
4.53 Any Income Received by any Person on behalf of certain Persons [Section 10(23C)]

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

(i) the Prime Minister's National Relief Fund; or
(ii) the Prime Minister's Fund (Promotion of Folk Art); or
(iii) the Prime Minister's Aid to Students Fund; or
(iiiia) the national foundation for communal harmony.

(iiiab) any university or other educational institution existing solely for educational purposes and not for purposes of profit and which is wholly or substantially financed by the Government.

(iiiac) any hospital or other institution for the reception and treatment of persons during convalescence or of persons suffering from illness or mental defectiveness or for the reception and treatment of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit and which is wholly or substantially financed by the Government.

(iiiad) any university or other educational institution existing solely for educational purposes and not for the purposes of profit, if the aggregate annual receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed.

(iiiae) any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for the purposes of profit, if the aggregate annual receipts of such hospital or institution do not exceed the amount of annual receipts as may be prescribed.

(iv) any other fund or institution established for charitable purposes which may be notified by the Central Government in the Official Gazette, having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States; or

(v) any trust (including any other legal obligation) or institution wholly for public religious and charitable purposes, as notified by the Central Government having regard to the manner in which the affairs of the trust or institution are administered and supervised for ensuring that the income accruing thereto is properly applied for the objects thereof.

(vi) any university or other educational institution existing solely for educational purposes and not for purposes of profit, other than those mentioned in (v) and (vii) supra and which may be approved by the prescribed authority.

(via) any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical
attention or rehabilitation existing solely for philanthropic purposes and not for purposes of profit other than those mentioned in (vi) and (viii) supra and which may be approved by the prescribed authority.

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

(a) publish its accounts in a local newspaper; and

(b) furnish alongwith exemption application, the copy of the local newspaper in which such accounts have been published.

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

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

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

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

(b) the fund or trust or institution applies its income or accumulates it for application wholly and exclusively to the objects for which it is established and invests or deposits its funds, other than -

(i) any assets held by the fund, trust or institution where such assets form part of the corpus of the fund, trust or institution or any university or other educational institution or any hospital or other medical institution as on the 1st day of June, 1973;

(ii) any assets (being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution where such asset form part of the corpus of any university or other educational institution or any hospital or other medical institution as on the 1st day of June, 1998.

(ii) any assets (being debentures issued by, or on behalf of, any company or corporation), acquired by the fund, trust or institution or any university or other educational institution or any hospital or other medical institution before the 1st day of March, 1983;
(iii) any accretion to the shares, forming part of the corpus mentioned in sub-clause (i) and (ia), by way of bonus shares allotted to the fund, trust or institution or any university or other educational institution or any hospital or other medical institution;

(iv) voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the Official Gazette, specify, for any period during the previous year in the forms and modes as specified in Section 11(5). In case of investments made before April 1, 1989 otherwise than in any one or more of the forms or modes as mentioned in Section 11(5), the same shall be exempt if such investments do not continue to remain so invested or deposited after the 30th day of March, 1993.

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

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

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

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

Further, the exemption under this clause shall be withdrawn if prescribed authority is satisfied that conditions are not being fulfilled after an opportunity of being heard is provided.
In case the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in the first proviso makes an application on or after the 1st day of June, 2006 for the purposes of grant of exemption or continuance thereof, such application shall be made on or before the 30th day of September of the relevant assessment year from which the exemption is sought.

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

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

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

Explanation: For the purpose of this clause:

(a) the expression ‘public sector bank’ means the State Bank of India constituted under the State Bank of India Act, 1955, a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959, a corresponding new Bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 and a bank included in the category ‘other public sector banks’ by the Reserve Bank of India;

(b) the expression ‘public financial institution” shall have the meaning assigned to it in Section 4A of the Companies Act, 1956.

The financial institutions specified by Section 4A of the Companies Act, 1956, are as follows:
(i) ICICI.
(ii) IFCI.
(iii) IDBI.
(iv) LIC.
(v) UTI.
(vi) The Industrial Reconstruction Corporation of India established under the Industrial Reconstruction Bank of India Act, 1984 (62 of 1984).
(x) The Oriental Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).
(xi) The United Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).

(xii) Risk Capital and Technology Finance Corporation Ltd.

(xiii) Technology Development and Information Company of India Ltd.

(c) the expression ‘Securities and Exchange Board of India’ shall have the meaning assigned to it in clause (a) of Sub-section (1) of Section 2 of the Securities and Exchange Board of India Act, 1992.

4.55 Income of Investor Protection Fund (Section 23EA)

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

Provided that where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a recognized 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.

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

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

4.57 Income of Venture Capital Company (Section 23FB)

Any income of a venture capital company or venture capital fund set up to raise funds for investment in a venture capital undertaking is exempt from the assessment year 2001-02

Explanation 1: For the purposes of this clause:

(a) ‘venture capital company’ means such company:
   (i) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and regulations made thereunder;
   (ii) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf;

(b) ‘venture capital fund’ means such fund:
   (i) operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908) or operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963;
   (ii) which has been granted a certificate of registration under the Securities...
and Exchange Board of India Act, 1992 (15 of 1992), and regulations
made thereunder;
(iii) which fulfils the conditions as may be specified, with the approval of the
Central Government, by the Securities and Exchange Board of India, by
notification in the Official Gazette in this behalf; and
(c) "venture capital undertaking" means a domestic company:
(i) whose shares are not listed in a recognised stock exchange in India;
(ii) which is engaged in the business for providing services, production or
manufacture of an article or thing but does not include such activities or
sectors which are specified, with the approval of the Central
Government, by the Securities and Exchange Board of India, by
notification in the Official Gazette, in this behalf.

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

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

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

The following incomes are exempt from tax under this provision:

(i) Interest on securities which are held by or which are the property of any
statutory provident fund to which the Provident Funds Act, 1925 applies and
any capital gains of the fund arising from the sale, exchange or transfer of
such securities.

(ii) Any income received by the trustees on behalf of a recognised provident
fund, an approved superannuation fund or an approved gratuity fund.

(iii) Any income received by the Board of Trustees constituted under the Coal
Mines Provident Fund and Miscellaneous Provisions Act, 1948, on behalf of
the Deposit-linked Insurance Fund.

(iv) Any income received by the Board of Trustees constituted under the
Employees' Provident Fund and Miscellaneous Provisions Act, 1952 on
behalf of the Deposit-linked Insurance Fund.

4.60 Exemption to Employees' State Insurance Fund [Section 10(25A)]

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

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

Members of a Scheduled Tribe as defined in Article 366(25) of the Constitution
residing in certain areas specified in paragraph 20 of the Sixth Schedule to the
Constitution or in the States of Arunachal Pradesh, Mizoram, Nagaland, Manipur and
Tripura or in the Ladakh region of the State of Jammu and Kashmir are exempt from
tax on any income which accrues or arises to them from any source in the area, State
or Union Territories mentioned above or by way of dividend or interest on securities
arising from any place in or outside India.

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

Any income accruing or arising to any person from any source in the district of
Ladakh or outside India in any previous year relevant to the assessment year
commencing before 1.4.1989 will be exempt from tax, where such person is resident
in the district of Ladakh in that previous year. However, this exemption would not
apply in the case of any such person unless he was resident in that district in the
previous year relevant to the assessment year 1962-63 or earlier. For the purposes
of this section the district of Ladakh will include all the areas comprised in that district
on June 30, 1979, that is, the date after which the said district was bifurcated.

4.63 Income of a Corporation Established for Promoting Interest of Scheduled
Castes etc. [Section 10(26B)]

Any income of a corporation established by a Central, State or Provincial Act or
any other body, institution or association wholly financed by government where it has
been formed for promoting the interest of the members of the Scheduled Castes or
the Scheduled Tribes or the backward classes or any two or all of them is exempt
from tax.

4.64 Exemption to National Minorities Development and Finance Corporation
[Section 10(26BB)]

With effect from the assessment year 1995-96 a new clause (26BB) has been
inserted in Section 10 to provide income-tax exemption on any income of a
corporation established by the Central Government or any State Government for
promoting the interests of the members of such minority communities as are notified
by the Central Government from time to time.

4.65 Exemption from Income of a Corporation established for the Welfare and
Economic Upliftment of Ex-servicemen being Citizens of India

Finance Act, 2003 has inserted a new clause (26BB) in Section 10 to provide
income-tax exemption on any income of a corporation established by a Central, State
or Provincial Act for the welfare and economic upliftment of ex-servicemen being the
citizens of India. [Section 10(26BBB)].

Explanation.—For the purposes of this clause, “ex-serviceman” means a person
who has served in any rank, whether as combatant or non-combatant, in the armed
forces of the Union or armed forces of the Indian States before the commencement
of the Constitution (but excluding the Assam Rifles, Defence Security Corps, General
Reserve Engineering Force, Lok Sahayak Sena, Jammu and Kashmir Militia and
Territorial Army) for a continuous period of not less than six months after attestation
and has been released, otherwise than by way of dismissal or discharge on account
of misconduct or inefficiency, and in the case of a deceased, or incapacitated ex-
serviceman includes his wife, children, father, mother, minor brother, widowed
daughter and widowed sister, wholly dependant upon such ex-serviceman
immediately before his death or incapacitation.
4.66 Income of Co-operative Societies Promoting the Interest of Members of Scheduled Castes, etc. [Section 10(27)]

Any income of a cooperative society formed for promoting the interests of the members of either the scheduled castes or scheduled tribes or both referred to in clause (26B) will be exempt from tax. In order to avail exemption the membership of the co-operative society should consist of only other co-operative societies formed for similar purposes and the finances of the society are provided by the government and such other societies.

4.67 Exemption of Commodity Boards and Authorities from Income-tax [Section 10(29A)]

A new clause (29A) has been inserted in Section 10. It provides that the income of certain commodity Boards and Export development authorities which are set up under various statutes and are under the administrative control of the Commerce Ministry will be exempt from income-tax. The specified boards and authorities are Coffee Board, the Rubber Board, the Tea Board, the Tobacco Board, the Marine Products Export development authority, the Agricultural and Processed Food Products Export Development Authority, the Spices Board and the coir Board established under section 4 of the Coir Industry Act (w.r.e.f 1st April, 2002). These Boards and authorities are exempt from the assessment year 1962-63 or the previous year in which these Boards or authorities were constituted, whichever is later.

4.68 Subsidy from the Tea Board [Section 10(30)]

In the case of an assessee engaged in the business of growing and manufacturing tea in India, the amount of Subsidy received from or through the Tea Board under any Notified Scheme of the Central Government for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea is exempt from income-tax.

For this purpose, the Central Government has notified the following schemes -

(1) Replantation Subsidy Scheme of the Tea Board from October 1, 1968 (effective date 1.4.1969);

(2) Amended Replantation Subsidy Scheme of the Tea Board as effective from May 12, 1970; and

(3) Amended Replantation Subsidy Scheme of the Tea Board as effective from January 1, 1972.

To qualify for the exemption, the assessee has to submit, along with his return of income or within such further time as may be allowed by the Assessing Officer, a certificate from the Tea Board as to the amount of subsidy received by him during the relevant previous year.

4.69 Subsidy from the Rubber; Coffee; Spices and other Board or authority established under any law and notified by the Central Government [Section 10(31)]

In the case of an assessee carrying on business of growing and manufacturing
rubber, coffee, cardamom or such other commodity in India, as notified by the Central Government, any subsidy received from or through the concerned Board(s) (as specified in the heading) under any scheme for replantation or replacement of rubber, coffee, cardamom or other specified commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom or other specified commodity will be exempt from tax if the assessee furnishes to the Assessing Officer, along with his return of income a certificate from the concerned Board, as to the amount of such subsidy paid to the assessee, either along with his return of income or within such further time as may be allowed by the Assessing Officer.

4.70 Income of minor child [Section 10(32)]

Where the income of an individual includes any income of his minor child in terms of Section 64(1A), such individual shall be entitled to exemption of the amount includible under Section 64(1A) of each minor child or ₹ 1,500 for each minor child whichever is less.

4.71 Income from transfer of units of UTI [Section 10(33)]

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 referred to in Schedule I to the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002) and where the transfer of such asset takes place on or after the 1st day of April, 2002 shall be exempt from income tax.

4.72 Any income by way of dividends referred to in Section 115-O [Section 10(34)]

Any income by way of dividends referred to in Section 115-O shall be exempt from income tax. As per section 115O the company paying or declaring any dividend have to pay tax @15% plus surcharge 5% plus education cess @3% on such dividend. Hence, such dividend shall be exempt in the hands of shareholders.

Explanation.—For the removal of doubts it is hereby declared that dividend referred to in Section 115-O shall not be included in the total income of the assessee, being a developer or entrepreneur (with effect from 01st June 2011, this explanation has been omitted by Finance Act, 2011) after 1st June 2011 the developing or operating units in SEZ shall also pay additional tax on dividend payable or declared. Hence the dividend shall be exempt in the hands of shareholders.

4.73 Income from Mutual Funds and certain units [Section 10(35)]

Any income by way of,—

(a) income received in respect of the units of a Mutual Fund specified under Clause (23D); or

(b) income received in respect of units from the Administrator of the specified undertaking; or

(c) income received in respect of units from the specified company

shall be exempt from income tax.

Provided that this clause shall not apply to any income arising from transfer of units of the Administrator of the specified undertaking or of the specified company or of a mutual fund, as the case may be.
**Explaination.**—For the purposes of this clause,—

(a) “Administrator” means the Administrator as referred to in clause (a) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);

(b) “specified company” means a company as referred to in clause (h) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);

**4.74 Transfer of Specified Equity Shares [Section 10(36)]**

Any income arising from the transfer of a long-term capital asset, being an eligible equity share in a company purchased on or after the 1st day of March, 2003 and before the 1st day of March, 2004 and held for a period of twelve months or more shall be exempt from income tax.

**Explaination.**—For the purposes of this clause, “eligible equity share” means,—

(i) any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange, Mumbai as on the 1st day of March, 2003 and the transactions of purchase and sale of such equity share are entered into on a recognised stock exchange in India;

(ii) any equity share in a company allotted through a public issue on or after the 1st day of March, 2003 and listed in a recognised stock exchange in India before the 1st day of March, 2004 and the transaction of sale of such share is entered into on a recognised stock exchange in India.

**4.75 Income from Transfer of Agricultural Land [Section 10(37)]**

In the case of an assessee, being an individual or a Hindu undivided family, any income chargeable under the head “Capital gains” arising from the transfer of agricultural land, where—

(i) such land is situate in any area referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of Section 2;

(ii) such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual or a parents;

(iii) such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India;

(iv) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after 1st day of April, 2004.

shall be exempt from income tax.

**Explaination.** For the purposes of this clause, the expression “compensation or consideration” includes the compensation or consideration enhanced or further enhances by any court, tribunal or other authority.

**4.76 Income from Transfer of certain equity, units etc. [Section 10(38)]**

Any income arising on or after 1.10.2004 from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund
where—

(a) the transaction of sale of such equity share or unit is entered into on or after the date on which Chapter VII of the Finance (No. 2) Act, 2004 comes into force; and

(b) such transaction is chargeable to securities transaction tax under that chapter.

shall be exempt from income tax.

Provided that the income by way of long-term capital gain of a company shall be taken into account in computing the book profit and the income tax payable under Section 115JB.

Explanation: For the purposes of this clause, “equity oriented fund” means a fund—

(i) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than sixty-five percent of the total proceeds of such fund; and

(ii) which has been set up under a scheme of Mutual Fund specified under clause 10(23D).

Provided that the percentage of equity share holding of the fund shall be computed with reference to the annual average of the monthly average of the opening and closing figures.

4.77 Income from international sporting events [Section 10(39)]

Any specified income, arising from any international sporting event held in India, to the person or persons notified by the Central Government in the Official Gazette, if such international sporting event—

(a) is approved by the international body regulating the international sport relating to such event;

(b) has participation by more than two countries;

(c) is notified by the Central Government in the Official Gazette for the purposes of this clause.

shall be exempt from income tax.

Explanation: For the purposes of this clause, “the specified income” means the income, of the nature and to the extent, arising from the international sporting event, which the Central Government may notify in this behalf;

4.78 Income from subsidiary company [Section 10(40)]

Any income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power if receipt of such income is for settlement of dues in connection with reconstruction or revival of an existing business of power generation shall be exempt from income tax.

Provided that the provisions of this clause shall apply if reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under sub-clause (a) of clause (v) of Sub-section (4) of Section 80-IA.
4.79 Income from transfer of a capital asset [Section 10(41)]

Any income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation or transmission or distribution of power where such transfer is effected on or before the 31st day of March, 2006, to the Indian company notified under sub-clause (a) of clause (v) of Sub-section (4) of Section 80-IA shall be exempt from income tax.

4.80 Specified income to a body or authority [Section 10(42)]

Any specified income arising to a body or authority which—

(a) has been established or constituted or appointed under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;

(b) is established or constituted or appointed not for the purposes of profit;

(c) is notified by the Central Government in the Official Gazette for the purposes of this clause.

Explanation: For the purposes of this clause, “specified income” means the income, of the nature and to the extent, arising to the body or authority referred to in this clause, which the Central Government may notify in this behalf.

4.81 Income to an Individual by way Reverse Mortgage [Section 10(43)]

Any amount received by an individual as a loan, either in lumpsum or in instalment, in a transaction of reverse mortgage referred to in clause (xvi) of Section 47.

**Meaning of Reverse Mortgage:**
Under reverse mortgage a person (generally senior citizen) who owns a house property have the option to mortgage the property with a schedule bank or housing finance company to get a regular income in the form of periodical instalments. This scheme is very attractive for senior citizens who do not have regular income. In this scheme, the lender (the bank or housing finance company) will recover the amount paid i.e principle and interest thereon by selling the property after the death of borrower. However the lender will have to give the option to the legal heirs of the borrower to repay the loan amount along with interest for the release of property.

4.82 New Pension System Trust [Section 10(44)]

Any income received by any person for, or on behalf of, the New Pension System Trust established on the 27th February, 2009 under the provisions of the Indian Trust Act, 1882 shall be exempt from Incom tax.

4.83 Allowance or Perquisite to the chairman of UPSC [Section 10(45)]

Allowances or perquisites which are notified by the Central Government in the Official Gazette shall be exempt in the hands of the Chairman or a retired Chairman or any other member or retired member of the Union Public Service Commission.

4.84 Income arising to a Body, Authority or Board or Trust or Commission [Section 10(46)]

Any specified income notified by the Central Government arising to a body or
authority or Board or Trust or Commission (by whatever name called) which:

(a) has been established or constituted by or under a Central, State or Provincial Act, or constituted by the Central Government or a State Government, with the object of regulating or administering any activity for the benefit of the general public;
(b) is not engaged in any commercial activity; and
(c) is notified by the Central Government in the Official Gazette

shall be exempt.

4.85 Income of an Infrastructure Debt Fund [Section 10(47)]

Any income of an infrastructure debt fund, set up in accordance with the guidelines as may be prescribed, which is notified by the Central Government in the Official Gazette shall be exempt.

PART II

4.86 Complete tax holiday for industrial units situated in free trade zones (Section 10A)

In India there are at present six free trade zones, namely, the Kandla Free Trade Zone, Santa Cruz Electronics Export Processing Zone, Falta Export Processing Zone, Madras Export Processing Zone, Cochin Export Processing Zone and Noida Export Processing Zone. These Free Trade Zones play an important role on the export front. With a view to encouraging establishment of export-oriented industries in the free trade zones, Section 10A provides complete tax exemption in respect of profits and gains derived from industrial undertakings set up in these zones for a period of ten consecutive years beginning with assessment year relevant to the previous year in which the undertaking starts its production activity. The salient features of tax-exemption under Section 10A are:

(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by an undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee:

Provided that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to the deduction referred to in this sub-section only for the unexpired period of the aforesaid ten consecutive assessment year:

Provided further that where an undertaking initially located in any free trade zone or export processing zone is subsequently located in a special economic zone by reason of conversion of such free trade zone or export processing zone into a special economic zone, the period of ten consecutive assessment years referred to in this sub-section shall be reckoned from the
assessment year relevant to the previous year in which the undertaking was first set up in such free trade zone or export processing zone:

Provided also that for the assessment year beginning on the 1st day of April, 2003, the deduction under this Sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software.

Provided also that the profits and gains derived from such domestic sales of articles or things or computer software as do not exceed twenty five per cent of total sales shall be deemed to be the profits and gains derived from the export of articles or things or computer software.

Provided also that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April 2012, and subsequent years (Extended by Finance Act, 2009).

(1A) Notwithstanding anything contained in Sub-section (1), the deduction, in computing the total income of an undertaking, which begins to manufacture or produce articles or things or computer software during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2003, in any special economic zone, shall be,—

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

(ii) for the next three 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 Allowance Reserve Account’) to be created and utilised for the purposes of the business of the assessee in the manner laid down in Sub-section (1B).

Provided that no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under Sub-section (1) of Section 139.

(1B) The deduction under clause (ii) of Sub-section (1A) shall be allowed only if the following conditions are fulfilled, namely:—

(a) the amount credited to the Special Economic Zone Reinvestment Allowance Reserve Account is to be utilised—

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

(ii) until the acquisition of new 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 prescribed in this behalf, have been furnished
 by the assessee in respect of new 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.

(1C) Where any amount credited to the Special Economic Zone re-investment
 Allowance Reserve Account under clause (ii) of Sub-section (1A),—

(a) has been utilised for any purpose other than those referred to in Sub-
 section (1B), the amount so utilised; or

(b) has not been utilised before the expiry of the period specified in
 sub-clause (i) of clause (a) of Sub-section (1B), 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 (1B).

and shall be charged to tax accordingly.”

(2) This section applies to any undertaking which fulfills all the following
 conditions, namely:

(i) it has begun or begins to manufacture or produce articles or things or
 computer software during the previous year relevant to the assessment
 year:

(a) commencing on or after the 1st day of April, 1981, in any free trade
 zone; or

(b) commencing on or after the 1st day of April, 1994, in any electronic
 hardware technology park or, as the case may be, software
 technology park;

(c) commencing on or after the 1st day of April, 2001, 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 which is formed as a result of the re-establishment,
 reconstruction or revival by the assessee of the business of any such
 undertakings 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 or plant
 previously used for any purpose.
Explanation: The provisions of Explanation 1 and Explanation 2 to Sub-section (2) of Section 80-I shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

(3) This section applies to the undertaking, if the sale proceeds of articles or things or computer software exported out of India are received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or within such further period as the competent authority may allow in this behalf.

Explanation 1: For the purposes of this sub-section, the expression "competent authority" means the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

Explanation 2: The sale proceeds referred to in this sub-section shall be deemed to have been received in India where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

(4) For the purposes of Sub-section (1) and (1A), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business; the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the assessee.

(5) The deduction under this section, shall not be admissible for any assessment year beginning on or after the 1st day of April, 2001, unless the assessee furnishes in the prescribed form, along with the return of income, the report of an 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.

(6) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years, or of any previous year, relevant to any subsequent assessment year:

(i) Section 32, Section 32A, Section 33, Section 35 and Clause (ix) of Sub-section (1) of Section 36 shall apply as if every allowance or deduction referred to therein and relating to or allowable for any of the relevant assessment years ending before the 1st day of April, 2001, in relation to any building, machinery, plant or furniture used for the purposes of the business of the undertaking in the previous year relevant to such assessment year or any expenditure incurred for the purposes of such business in such previous year had been given full effect to for that assessment year itself and accordingly Sub-section (2) of Section 32, Clause (ii) of Sub-section (3) of Section 32A, Clause (ii) of Sub-section (2) of Section 33, Sub-section (4) of Section 35 or the second proviso to clause (ix) of Sub-section (1) of Section 36, as the case may be, shall not apply in relation to any such allowance or deduction:
(ii) no loss referred to in Sub-section (1) of Section 72 or Sub-section (1) or Sub-section (3) of Section 74 in so far as such loss relates to the business of the undertaking, shall be carried forward or set off where such loss relates to any of the relevant assessment years ending before the 1st day of April, 2001;

(iii) no deduction shall be allowed under Section 80HH or Section 80HHA or Section 80-I or Section 80-IA or Section 80-IB in relation to the profits and gains of the undertaking; and

(iv) in computing the depreciation allowance under Section 32, the written down value of any asset used for the purposes of the business of the undertaking shall be computed as if the assessee had claimed and been actually allowed the deduction in respect of depreciation for each of the relevant assessment year.

(7) The provisions of Sub-section (8) and Sub-section (10) of Section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in Section 80-IA.

(7A) 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.

(8) Notwithstanding anything contained in the foregoing provisions of this section, where the assessee, before the due date for furnishing the return of income under Sub-section (1) of Section 139, furnishes to the Assessing Officer a declaration in writing that the provisions of this section may not be made applicable to him, the provisions of this section shall not apply to him for any of the relevant assessment years.

Explanation 2: For the purposes of this section:

(i) "computer software" means:

(a) any computer programme recorded on any disc, tape, perforated media or other information storage device; or

(b) any customized electronic data or any product or service of similar nature, as may be notified by the Board, which is transmitted or exported from India to any place outside India by any means;

(ii) "convertible foreign exchange" means foreign exchange which is for the time
being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Regulation Act, 1973 (46 of 1973), and any rules made thereunder or any other corresponding law for the time being in force;

(iii) “electronic hardware technology park” means any park set up in accordance with the Electronic Hardware Technology Park (EHTP) scheme notified by the Government of India in the Ministry of Commerce and Industry;

(iv) “export turnover” means the consideration in respect of export of articles or things or computer software received in, or brought into India by the assessee in convertible foreign exchange in accordance with Sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India.

(v) “free trade zone” means the Kandla Free Trade Zone and the Santacruz Electronics Export Processing Zone and includes any other free trade zone which the Central Government may, by notification in the Official Gazette, specify for the purposes of this section;

(vi) “relevant assessment year” means any assessment year falling within a period of ten consecutive assessment years referred to in this section;

(vii) “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;

(viii) “special economic zone” means a zone which the Central Government may, by notification in the Official Gazette, specify as a special economic zone for the purposes of this section.

Explanation 3: For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Explanation 4.—For the purposes of this section, “manufacture or produce” shall include the cutting and polishing of precious and semi-precious stones.

Note: No deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, 2012 (from assessment year 2012-13) and subsequent years.

4.86A Special provisions in respect of newly established Units in Special Economic Zone

10AA. (1) Subject to the provisions of this section, in computing the (j) of section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any service during the previous year relevant

* Now replaced by Foreign Exchange Management Act, 1999.
to any assessment year commencing on or after the 1st day of April, 2006, a
deduction of—

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

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

(2) The deduction under clause (ii) of sub-section (1) shall be allowed only if the
following conditions are fulfilled, namely:

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

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

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

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

(3) Where any amount credited to the Special Economic Zone Re-investment
Reserve Account under clause (ii) of sub-section (1),—

(a) has been utilised for any purpose other than those referred to in sub-section
(2), the amount so utilised; or

(b) has not been utilised before the expiry of the period specified in sub-clause
(i) of clause (a) of sub-section (2), the amount not so utilised,
shall be deemed to be the profits,—

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

(ii) in a case referred to in clause (b), in the year immediately following the period
of three years specified in sub-clause (i) of clause (a) of sub-section (2),
and shall be charged to tax accordingly:

Provided that where in computing the total income of the Unit for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (7B) of section 10A, the undertaking, being the Unit shall be entitled to deduction referred to in this sub-section only for the unexpired period of ten consecutive assessment years and thereafter it shall be eligible for deduction from income as provided in clause (ii) of sub-section (1).

Explanation: For the removal of doubts, it is hereby declared that an undertaking, being the Unit, which had already availed, before the commencement of the Special Economic Zones Act, 2005, the deductions referred to in section 10A for ten consecutive assessment years, such Unit shall not be eligible for deduction from income under this section:

Provided further that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone, the period of ten consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such free trade zone or export processing zone:

Provided also that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone and has completed the period of ten consecutive assessment years referred to above, it shall not be eligible for deduction from income as provided in clause (ii) of sub-section (1) with effect from the 1st day of April, 2006.

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

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

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

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

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

Explanation: The provisions of Explanations 1 and 2 to sub-section (3) of section 80-IA shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.
(5) Where any undertaking being the Unit which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger,—

(a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit, being the company for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section shall, as they would have applied to the amalgamating or the demerged Unit being the company as if the amalgamation or demerger had not taken place.

(6) Loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74, in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.

(7) For the purposes of sub-section (1), the profits derived from the export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the undertaking (Substituted for the word ‘Assessee’ by Finance Act, 2009).

Provided that the provisions of this section shall retrospectively applicable from assessment year beginning on 1st day of April 2006 and subsequent assessment year.

(8) The provisions of sub-sections (5) and (6) of section 10A shall apply to the articles or things or services referred to in sub-section (1) as if—

(a) for the figures, letters and word ‘1st April, 2001’, the figures, letters and word ‘1st April, 2006’ had been substituted;

(b) for the word ‘undertaking’, the words ‘undertaking, being the Unit’ had been substituted.

(9) The provisions of sub-section (8) and sub-section (1) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.

Explanation 1.—For the purposes of this section,—

(i) ‘export turnover’ means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services (including computer software) outside India;

(ii) ‘export in relation to the Special Economic Zones’ means taking goods or providing services out of India from a Special Economic Zone by land, sea, air, or by any other mode, whether physical or otherwise;

(iii) ‘manufacture’ shall have the same meaning as assigned to it in clause (r) of section 2 of the Special Economic Zones Act, 2005;
(iv) "relevant assessment year" means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section;

(v) "Special Economic Zone" and "Unit" shall have the same meanings as assigned to them under clauses (za) and (zc) of section 2 of the Special Economic Zones Act, 2005.

Explanation 2.—For the removal of doubts, it is hereby declare that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

4.87 Special provision in respect of newly established 100% export oriented undertakings (Section 10B)

Section 10B provides that any profits and gains derived by an assessee from a 100% export oriented undertaking [i.e. an undertaking approved as such by the board appointed in this behalf by the Central Government in exercise of the powers conferred by Section 14 of the Industries (Development and Regulation) Act, 1951 and the rules made there under], shall not be included in the total income of the assessee. The other features of this section are:

(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee:

Provided that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to deduction referred to in this sub-section only for the unexpired period of the aforesaid ten consecutive assessment years:

Provided further that the profits and gains derived from such domestic sales of articles or things or computer software as do not exceed twenty-five per cent of total sales shall be deemed to be the profits and gains derived from the export of articles or things or computer software.

Provided further that for the assessment year beginning on the 1st day of April, 2003, the deduction under this sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software.

Provided also that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April 2012, and subsequent years (extended by the Finance Act, 2009).

Provided also that no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under Section 139(1).
(2) This section applies to any undertaking which fulfills all the following conditions, namely:

(i) it manufactures or produces any articles or things or computer software;

(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 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;

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

Explanation: The provisions of Explanation 1 and Explanation 2 to Sub-section (2) of Section 80-I shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

(3) This section applies to the undertaking, if the sale proceeds of articles or things or computer software exported out of India are received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or, within such further period as the competent authority may allow in this behalf.

Explanation 1: For the purposes of this sub-section, the expression “competent authority” means the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

Explanation 2: The sale proceeds referred to in this sub-section shall be deemed to have been received in India where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

(4) For the purposes of Sub-section (1), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business; the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the assessee.

(5) The deduction under Sub-section (1), shall not be admissible for any assessment year beginning on or after the 1st day of April, 2001, unless the assessee furnishes in the prescribed form, along with the return of income, the report of an 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.

(6) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years, or of any previous year, relevant to any subsequent
assessment year:

(i) Section 32, Section 32A, Section 33, Section 35 and Clause (ix) of Sub-section (1) of Section 36 shall apply as if every allowance or deduction referred to therein and relating to or allowable for any of the relevant assessment years ending before the 1st day of April 2001, in relation to any building, machinery, plant or furniture used for the purposes of the business of the undertaking in the previous year relevant to such assessment year or any expenditure incurred for the purposes of such business in such previous year had been given full effect to for that assessment year itself and accordingly Sub-section (2) of Section 32, Clause (ii) of Sub-section (3) of Section 32A, Clause (ii) of Sub-section (2) of Section 33, Sub-section (4) of Section 35 or the second proviso to clause (ix) of Sub-section (1) of Section 36, as the case may be, shall not apply in relation to any such allowances or deduction;

(ii) no loss referred to in Sub-section (1) of Section 72 or Sub-section (1) or Sub-section (3) of Section 74, in so far as such loss relates to the business of the undertaking, shall be carried forward or set-off where such loss relates to any of the relevant assessment years ending before the 1st day of April 2001;

(iii) no deduction shall be allowed under Section 80HH or Section 80HHA or Section 80-I or Section 80-IA or Section 80-IB in relation to the profits and gains of the undertaking; and

(iv) in computing the depreciation allowance under Section 32, the written down value of any asset used for the purposes of the business of the undertaking shall be computed as if the assessee had claimed and been actually allowed the deduction in respect of depreciation for each of the relevant assessment year.

(7) The provisions of Sub-section (8) and Sub-section (10) of Section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in Section 80-IA.

(7A) 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.

(8) Notwithstanding anything contained in the foregoing provisions of this section, where the assessee, before the due date for furnishing the return of income under Sub-section (1) of Section 139, furnishes to the Assessing Officer a declaration in writing that the provisions of this section may not be
made applicable to him, the provisions of this section shall not apply to him for any of the relevant assessment years.

Section 9 or 9A omitted by Finance Act, 2003 w.e.f. 1st April, 2004.

Explanation 2: For the purposes of this section:

(i) "computer software" means:
   (a) any computer programme recorded on any disc, tape, perforated media or other information storage device; or
   (b) any customized electronic data or any product or service of similar nature, as may be notified by the Board, which is transmitted or exported from India to any place outside India by any means;

(ii) "convertible foreign exchange" means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the *Foreign Exchange Regulation Act, 1973 (46 of 1973), and any rules made thereunder or any other corresponding law for the time being in force;

(iii) "export turnover" means the consideration in respect of export of articles or things or computer software received in, or brought into India by the assessee in convertible foreign exchange in accordance with Sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India;

(iv) "hundred per cent export-oriented undertaking" means an undertaking which has been approved as a hundred per cent export-oriented undertaking by the Board appointed in this behalf by the Central Government in exercise of the powers conferred by Section 14 of the Industries (Development and Regulation) Act, 1951 (65 of 1951), and the rules made under the Act;

(v) "relevant assessment years" means any assessment year falling within a period of ten consecutive assessment years, referred to in this section;

Explanation 3: For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Explanation 4.—For the purposes of this section, "manufacture or produce" shall include the cutting and polishing of precious and semi-precious stones.

4.88 Meaning of computer programmes in certain cases

The profits and gains derived by an undertaking from the production of computer programmes under Section 10B, as it stood prior to its substitution by Section 7 of the Finance Act, 2000 (10 of 2000), shall be construed as if for the words "computer

* Now replaced by Foreign Exchange Management Act, 1999.
programmes”, the words “computer programmes or processing or management of electronic data” had been substituted in that section.

An undertaking set up in Domestic Tariff Area, which is subsequently approved as 100% EOU by the Board appointed by the Central Government in exercise of powers conferred under section 14 of the Industries (Development and Regulation) Act, 1951, whether eligible for deduction under section 10B – An undertaking set up in Domestic Tariff Area (DTA) and deriving profit from export of articles or things or computer software manufactured or produced by it, which is subsequently converted into a EOU, shall be eligible for deduction under section 10B, on getting approval as 100% export oriented undertaking. In such a case, the deduction shall be available only from the year in which it has got the approval as 100% EOU and shall be available only for the remaining period of ten consecutive assessment years, beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as a DTA unit. Further, in the year of approval, the deduction shall be restricted to the profits derived from exports, from and after the date of approval of the DTA unit as 100% EOU. Moreover, the deduction to such units in any case will not be available after assessment year 2009-10.

To clarify the above position, certain illustrations are given as under:

(i) Undertaking ‘A’ is set up in Domestic Tariff Area and starts manufacture or production of computer software in financial year 1999-2000 relevant to assessment year 2000-01. It gets approval as 100% EOU on 10.9.2004 in the financial year 2004-05 relevant to assessment year 2005-06. Accordingly, it shall be eligible for deduction under section 10B from assessment year 2005-06, i.e., the year in which it fulfils the basic condition of being a 100% EOU. Further, the deduction shall be available only for the remaining period of ten years, i.e., from assessment year 2005-06 to assessment year 2009-10. This deduction under section 10B for assessment year 2005-06 shall be restricted to the profits derived from exports, from and after the date of approval of the DTA unit as 100% EOU.

(ii) Undertaking ‘B’ set up in Domestic Tariff Area, begins to manufacture or produce computer software in financial year 1996-97 relevant to assessment year 1997-98. It gets approval as 100% EOU in financial year 2007-08 relevant to assessment year 2008-09. No deduction under Section 10B shall be admissible to undertaking B as the period of 10 years expires in financial year 2005-06 relevant to assessment year 2006-07, prior to its approval as 100% EOU.

(iii) Undertaking ‘C’ is set up in Domestic Tariff Area in the financial year 2000-01 relevant to assessment year 2001-02 and engaged in the business of providing computer related services, other than those notified by the Board for the purposes of section 10B. In financial year 2002-03, it acquires more than 20% of old plant & machinery and starts manufacturing computer software. It also gets approval as 100% EOU in financial year 2002-03. Undertaking ‘C’ shall not be eligible for deduction under section 10B, as there has been transfer of old plant and machinery.

(iv) Undertaking ‘D’ is set up and starts producing computer software in financial year 2003-04 relevant to assessment year 2004-05. It gets approval as 100%
EOU in financial year 2006-07 relevant to assessment year 2007-08. It shall be eligible for deduction under section 10B from assessment year 2007-08. However, the deduction shall not be available after assessment year 2009-10.


4.89 Special provision in respect of certain industrial undertakings in North-Eastern region (Section 10C)

Section 10C has been inserted with effect from the assessment year 1999-2000 which provides that any profits and gains derived by an assessee from an industrial undertaking which has begun or begins to manufacture or produce any article or thing on or after 1st April, 1998 in any Integrated Infrastructure Development Centre or Industrial Growth Centre located in the North-Eastern Region will not be included in the total income of the assessee.

(i) The expression ‘Integrated Infrastructure Development Centre’ means such centres located in the States of the North-Eastern Region, which the Central Government, may, by notification in the Official Gazette, specify for the purposes of this section.

(ii) The expression ‘Industrial Growth Centre’ means such centres located in the States of the North-Eastern Region, which the Central Government may, by notification in the Official Gazette, specify for the purposes of this section.

(iii) The expression ‘North-Eastern Region’ means the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura.

However, the following conditions must be satisfied to claim exemption under Section 10C:

1. Should not be formed by splitting/reconstruction of business: The industrial undertaking should not have been formed by the splitting up or reconstruction of a business already in existence. However, where an industrial undertaking is formed as a result of re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in Section 33B, in the circumstances and within the period specified in that section, the same will qualify for the tax concession.

2. Should not be formed by transfer of old machinery: The industrial undertaking should not have been formed by the transfer to a new business of machinery or plant previously used for any purpose. For this purpose, any machinery or plant which was used outside India by any person other than the assessee is not regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled, namely:

   (a) such machinery or plant was not previously used in India;

   (b) such machinery or plant is imported into India from a foreign country; and
(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable in computing the total income of any person for any period prior to the installation of the machinery or plant by the assessee.

Further, this tax concession is not denied in a case where the total value of used machinery or plant transferred to the new business does not exceed 20 per cent of the total value of the machinery or plant used in that business.

Amount and period of exemption: If the aforesaid conditions are satisfied, then a complete tax exemption will be available in respect of 10 consecutive assessment years beginning with assessment year relevant to the previous year in which the industrial undertaking begins to manufacture/produce articles or things.

Impact of claiming exemption under Section 10C: Section 10C(4) provides the following:

1. In computing the total income of the assessee after the expiry of tax holiday period, the unabsorbed depreciation allowance under Section 32(2), unabsorbed capital expenditure or scientific research under Section 35 and unabsorbed capital expenditure under Section 36(1)(ix) relating to the tax holiday period will not be taken into consideration.
2. Unabsorbed business loss or loss under the head ‘Capital gains’ relating to the tax holiday period will not be taken into account after the expiry of the tax holiday period.
3. After the expiry of tax holiday period, no deduction will be available under Sections 80HH, 80HHA, 80-I, 80-IA, 80-IB and 80JJA.
4. Further, in computing the depreciation allowance on any asset in the assessment years following the tax holiday period, the written down value of the assets will be computed as if the assessee had claimed and had been allowed the depreciation in accordance with the provisions of the Act during each one of the relevant assessment years.

Option available to new undertaking not to claim tax holiday under Section 10C: Section 10C will be applicable to all eligible undertakings unless the assessee opts out of scheme by making a declaration under Sub-section (6) before the due date of furnishing return of income.

Test Your Knowledge
Export turnover includes freight and telecommunication charges. True or False.
Correct Answer: False

PART III
TAX EXEMPTIONS FOR CHARITABLE TRUSTS AND INSTITUTIONS

4.90 Meaning of certain terms

Income of a Trust or Institution from property held for charitable or religious purposes:
Before the discussion of the provisions of the Income-tax Act in this connection, it is important to note the meanings of the terms - Trust, Institution, Income from property, Charitable purpose and Religious purpose.

(a) **Trust:** Section 3 of the Indian Trusts Act defines a trust to mean "an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another and the owner".

(b) **Institution:** An organisation with a constitution composed of a President, Vice-President, Secretary, Committee Members and ordinary members, is known as an Institution. The activities of the institution and its office-holders are regulated by rules and bye-laws of the institution. A university or a Chamber of Commerce is an Institution.

(c) **Income from property:** This includes income from movable or immovable property, voluntary donations received and income from business undertaking(s) held by the trust.

(d) **Charitable purpose:** The term 'charitable purpose' has been defined in this Act in a wider sense than what is commonly understood. According to Section 2(15) of the Act, it includes relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and advancement of any other object of general public utility not involving the carrying on of any activity for profit.

In order to qualify for tax exemptions the charity must be of a public character, and the trust or institution should not be created or established for the benefit of any particular religious community or caste, if the trust or institution is established for the benefit of the member of a club or employees of a factory, it would not be a public charitable trust. Vide Circular No. 395 dated Sept. 24, 1984 promotion of sports and games is considered to be a charitable purpose within the meaning of Section 2(15). Accordingly an association or institution, engaged in the promotion of sports or games can claim exemption under Section 11, even if it is not approved under Section 10(23).

**Case Laws:**

1. **C.I.T. v. Andhra Chamber of Commerce**

   In the case of **C.I.T. v. Andhra Chamber of Commerce**, the Supreme Court has held that profit making was not the predominant object of the activity carried on by the Chamber of Commerce but its predominant object was to promote trade and commerce which was an object of general public utility, hence, its income was exempt from tax under Section 11(1) [(1981) 130 I.T.R. 184].
2. C.I.T. v. Bar Council of Maharashtra

In the case of C.I.T. v. Bar Council of Maharashtra, the Supreme Court has held that the primary object of State Bar Council is the advancement of an object of public utility. Its income-enrolment fees is exempt under Section 10(23A) and interest on securities under Section 11 [(1981) 130 I.T.R. 28].

3. C.I.T. v. Federation of Indian Chambers of Commerce and Industry

In the case of C.I.T. v. Federation of Indian Chambers of Commerce and Industry, the Supreme Court has held that the income of the Federation from conducting trades, fair rent for space allotted, sale of entry and gate tickets, Government grant-in-aid for organising Afro-Asian Conference and fees for arbitration is exempt under Section 11(1) as the purpose is of charitable nature [(1981) 130 I.T.R. 186].


The Brick Kiln Owners Association derived income from admission fees, membership subscription and rent from buildings belonging to it. The Association purchased coal and supplied the same to members at same price. It is held that the dominant intention was to promote brick kiln trade. Hence, the income of the association is exempt under Section 11. [Asst. C.I.T. v. Delhi Brick Kiln Owners Association (1981) 130 I.T.R. 55 (Delhi)].

(e) Religious purpose: this includes the advancement, support or propagation of a religion and its tenets. For this purpose no distinction is made between one religion and the other. The income of a religious trust or institution is entitled to exemption even though it may be for the benefit of a particular caste or community but the religious trust or institution must be of a public character.

Sections 11, 12, 12A and 13 of the Income-tax Act contain provisions for granting tax exemption to charitable trusts and institutions in respect of the income derived by them. The exemption is over and above the various items of income exempt under Section 10 of the Income-tax Act. But this exemption is, however, subject to the provisions of Sections 60 to 63 of the Act under which the income of other persons is included in the total income of the assessee for purposes of Income-tax assessment.

4.91 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.
Case Laws:


Where a charitable trust donates income to another charitable trust, such donations amount to application of income for charitable purposes and the donating trust is entitled to exemption.


The expression ‘applied to’ does not mean actual spending only, it includes creation of a liability. Where the amount has been sanctioned by passing a resolution and the donee has been informed, it shall be deemed that the amount has been ‘applied to’ and the exemption cannot be denied.


The income from the properties has to be applied for the objects of the trust. As far as the objects of the trust are concerned, the application of the amount can be for revenue or capital purposes. But, the mere fact that the application of the trust income resulted in the maintenance or improvement of property held under trust for charitable purposes would not entitle the trust to exemption of such income under Section 11

(ii) **Income derived from property held under trust in part only for charitable or religious purposes:** Income derived from property held under trust in part only for charitable or religious purposes shall be exempt. This exemption would, however, be available only for trusts created before 1.4.1962. Further, where any such income is finally set apart for application to such purposes in India, shall be exempt to the extent to which the income so set apart is not in excess of 15% of the income from such property.

(iii) **Income from property held under trust created on or after 1.4.1952** for a charitable purpose which tends to promote international welfare in which India is interested shall be exempt to the extent to which such income is applied for such charitable purposes outside India.

(iv) **Income from property held under trust created before 1.4.1952** for charitable or religious purposes shall be exempt to the extent to which such income is applied for such purposes outside India. This exemption is, however, subject to the condition that the Central Board of Direct Taxes has, by a general or special order, issued a direction in either of the above two cases that the income in question would not be included in the total income of the person in receipt of such income.

(v) **Income in the form of voluntary contributions** made with a specific direction that they shall form part of the corpus of the trust or institution shall be fully exempt.

**Explanation:**

In respect of items (i) and (ii) above:
(1) In computing the 15% of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in Section 12 (dealt with later in this Chapter) shall be deemed to be part of the income.

(2) If, in the previous year, the income applied to charitable or religious purposes in India falls short of 85% of the income derived during that year from property held under trust, by any amount on account of (i) not receiving the income during that year, or (ii) for any other reason, then:

(a) In case referred to in (i), so much of the income applied to such purpose in India during the previous year in which the income is received or during the previous year immediately following as does not exceed the said amount shall be deemed to be income applied to such purposes during the previous year in which the income was derived; and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes during the previous year in which the income is received or during the previous year immediately following, as the case may be.

(b) In case referred to in (ii), so much of the income applied to such purposes in India during the previous year immediately following the previous year in which the income was derived as does not exceed the said amount shall be deemed to be income applied to such purposes during the previous year in which the income was derived; and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes during the previous year immediately following the previous year in which the income was derived.

Where any income as discussed in (a) and (b) above is not applied to charitable or religious purposes in India within the prescribed time, then such income shall be deemed to be the income of the person in receipt thereof:

(a) In case of not receiving the income: Such income shall be deemed to be the income of the previous year immediately following the previous year in which the income was received.

(b) In any other case: Such income shall be deemed to be the income of the previous year immediately following the previous year in which the income was derived [Clause (1B)].

4.92 Capital Gains [Section 11(1A)]

Asset held wholly for religious purposes or charitable purposes

Sometimes a capital asset held under trust wholly for charitable or religious purposes is transferred resulting in a capital gain. The net consideration received on such transfer may be utilised wholly or in part in acquiring another capital asset to be so held wholly for religious or charitable purposes. In such cases the capital gains arising from the transfer shall be deemed to have been applied for charitable or religious purposes to the extent stated hereinbelow:

(i) Where the whole of the net consideration is utilised for acquiring the new capital assets, so much of the capital gains.

(ii) Where only a part of the net consideration is utilised for acquiring the new
capital asset, so much of the capital gain as is equal to the amount by which the amount so utilised exceeds the cost of the transferred asset.

**Example 1:** A charitable trust had a capital asset the cost of which was ₹80,000 and it sold the same for ₹1,00,000. The whole of the consideration, i.e., ₹1,00,000 will be exempt from capital gains tax if a new capital asset is bought for ₹1,00,000.

**Example 2:** If a trust had a capital asset costing ₹1,00,000 and sold the same for ₹1,50,000 and then bought a capital asset for ₹1,30,000, then the working will be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds of old asset</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Cost of the old asset</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Capital gain</td>
<td></td>
</tr>
<tr>
<td>Cost of the new asset</td>
<td>1,30,000</td>
</tr>
<tr>
<td>Cost of the old asset</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Capital gain utilised is</td>
<td>30,000</td>
</tr>
<tr>
<td>Capital gain taxable is</td>
<td>20,000</td>
</tr>
</tbody>
</table>

**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 hereunder:

(i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;

(ii) in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

**Explanation** to Section 11(1A) provides:

- *Appropriate fraction* means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes.

- *Cost of the transferred asset* means the aggregate of the cost of acquisition (as ascertained for the purposes of Section 48 and 49 of the capital asset which is the subject of the transfer and the cost of any improvement thereto within the meaning assigned to that expression in sub-clause (b) of clause (1) of Section 55.

- *Net consideration* means the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.
Illustration

A trust has a capital asset costing ₹ 2,00,000 and 1/2 of its income is utilised for charitable purpose. It is sold for ₹ 3,50,000. If the trust buys another capital asset for ₹ 3,50,000 then appropriate fraction of the capital gain (₹ 3,50,000 - ₹ 2,00,000 = ₹ 1,50,000) i.e. ₹75,000 (½ of ₹ 1,50,000) will be deemed to have been applied for charitable purpose. Supposing that the trust buys another asset for ₹ 2,90,000, then the workings would be as shown hereunder:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gain on transfer of capital asset</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Appropriate fraction i.e. 1/2</td>
<td>75,000</td>
</tr>
<tr>
<td>Appropriate fraction utilised (1/2 of ₹ 2,90,000)</td>
<td>1,45,000</td>
</tr>
<tr>
<td>Appropriate fraction of the original capital asset</td>
<td></td>
</tr>
<tr>
<td>1/2 of ₹ 2,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Capital gain utilised</td>
<td>45,000</td>
</tr>
<tr>
<td>Capital gain not utilised</td>
<td>30,000</td>
</tr>
</tbody>
</table>

4.93 Accumulations of Income [Section 11(2)]

While dealing with Section 11 it has been stated that accumulation of income from trust property held for charitable purpose is permissible up to 15 per cent without attracting any liability to tax. Where the balance 85 per cent of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year, such income so accumulated or set apart shall not be included in the total income if the following conditions are fulfilled:

(i) the assessee gives a notice to the Assessing Officer, in the prescribed manner, specifying the purpose for which the income is being accumulated or set apart and the period for which income is to be accumulated or set apart which shall in no case exceed 10 years.

(ii) the money so accumulated or set apart is invested or deposited in the forms or modes specified in Sub-section (5).

However, in respect of any income accumulated or set apart on or after the 1st day of April, 2001 the provisions of this sub-section shall have effect as if for the words “ten years” at both the places where they occur, the words “five years” has been substituted.

Explanation: Any amount credited or paid, out of income referred to in clause (a) or clause (b) of Sub-section (1), read with the explanation to that sub-section, which is not applied, but is accumulated or set apart, to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

It is important to note that to claim exemption subject to Section 11(2) it is enough to invest in Government securities etc., only that part of the unspent balance which falls over and above 15% of the total income derived from the property held.

Section 11(3) provides that:

(i) if the income accumulated for the specific purpose under Section 11(2) is applied to purposes other than charitable or religious, or ceases to be accumulated or set apart for application thereto, it will be chargeable to tax as income of that year. Further, such accumulated income will become liable to be taxed if,

(ii) it ceases to remain invested in any security or deposited in the manner provided under Section 11(5), or

(iii) it is not utilised for the purpose for which it is so accumulated or set apart during the specified period, or in the year immediately following the expiry thereof;

(iv) is credited or paid to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10.

it shall be deemed to be the income of the previous year in which it ceases to remain so invested or deposited or is not so utilised, as the case may be.

Section 11(3A) provides that where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in accordance with the provisions of Section 11(2) cannot be applied for the purpose for which it was accumulated or set apart, the Assessing Officer may, on an application made to him in this behalf allow such person to apply such income for such other charitable or religious purpose in India, as is specified by the person in the application subject further to the condition that it is in conformity with the objects of the trust.

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of Sub-section (3) of section 11.

For the purposes of Section 11, 'property held under trust' includes a business undertaking so held and where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of the Income-tax Act relating to assessment and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious.

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of Sub-section (3) of Section 11:

Provided further that in case the trust or institution, which has invested or deposited its income in accordance with the provisions of clause (b) of Sub-section (2), is dissolved, the Assessing Officer may allow application of such
income for the purposes referred to in clause (d) of Sub-section (3) in the year in which such trust or institution was dissolved.

Sub-section (4A) as substituted by Finance Act, 1991 with effect from 1.4.1992 states that Sub-sections (1) or (2) or (3) or (3A) of Section 11 shall not apply in relation to any business income of a trust or institution unless the business is incidental to the attainment of the objectives of the trust or institution and separate books of accounts are maintained by such trust or institution in respect of such business.

**Forms and Modes of Investment [Section 11(5)]**

The forms and modes for investing funds of charitable and religious trusts and institutions are given hereunder:

(i) investment in saving certificates as defined in clause (c) of Section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government. Investments in Indira Vikas Patra and Kisan Vikas Patra also qualify for the purpose of this Section;

(ii) deposit in any account with the Post Office Savings Bank;

(iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank);

**Explanation:** In this clause, “scheduled bank” means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(iv) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(v) investment in any security for money created and issued by the Central Government or a State Government;

(vi) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;

(vii) investment or deposit in any public sector company;

Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company:

(A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;
(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;

(ix a) 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.

4.94 Income from Voluntary Contributions (Section 12)

(1) The income of a trust by way of voluntary contributions would also be treated for all purposes as income deemed to have been derived by the trust from property held by it under trust except, however, in case where the voluntary contribution is received with a specific direction that it shall form part of the corpus of the trust. As a result, voluntary contribution received by a trust should also be applied for charitable purposes before the end of the accounting year or within 3 months following so that income-tax exemption could be availed of. However, voluntary contributions could be accumulated for future obligation for charitable purposes in the same manner as specified earlier.
(2) The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any person referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3) of Section 13, shall be deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax notwithstanding the provisions of Sub-section (1) of Section 11.

Explanation: For the purposes of this sub-section, the expression "value" shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3) of Section 13.

(3) Notwithstanding anything contained in Section 11, any amount of donation received by the trust or institution in terms of Clause (d) of Sub-section (2) of Section 80G which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of Sub-section 5(C) of Section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, and not transferred to the Prime Minister's National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

Test Your Knowledge

Income in the form of voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution shall be fully exempt?
* True
* False

Correct answer: True

4.95 Income to be included in Total Income [Section 13(1)]

The exemption granted by Sections 11 or 12 of the Act would not, however, be available in the following cases and circumstances:

(a) Where any part of the income from property held under trust for private religious purposes does not enure for the benefit of the public;

(b) In the case of a trust for charitable purposes or an institution created or established for charitable purposes on or after 1.4.1962, any income of the trust will not qualify for tax exemption if the trust or institution is created or established for benefit of any particular religious community or caste. By virtue of explanation 2 to Section 13, any trust created for the benefit of Scheduled Castes, backward classes, or Scheduled Tribes or women or children would not be deemed to be a trust or institution created or established for the benefit of any particular religious community or caste for purposes of this exemption. Consequently, income derived by trusts or
institutions established purely for the benefit of scheduled castes or tribes or backward classes or women or children would qualify for tax exemption even though the income is applied in reality for the benefit of a particular community or caste.

(c) In the case of a trust or institution established after 1.4.1962 or in the case of a trust, whenever created or established, if the income of the trust or institution is applied during the accounting year, directly or indirectly for benefit of any of the specified persons or if under the terms of the trust or the rules governing that institution, any part of the income of the trust enures for the benefit of such specified persons, whether directly or indirectly, the trust would not be given tax exemption under Section 11, with the exception that (i) where such use or application is by way of compliance with a mandatory term of the trust or a mandatory rule governing the institution, and (ii) where such use or application relates to any period before the 1st day of June, 1970, the aforementioned provision shall not apply.

(d) Where any business is owned by a religious or charitable trust or institution, the income of such business shall be determined by the Assessing Officer in the same way as the assessment of business income of any other assessee. Consequently, any additions to the business income shown in the accounts of the assessee made by the Assessing Officer is deemed to be income applied by the trust for purposes other than charitable or religious. Such additions, therefore, do not qualify for tax exemptions under Section 11(4).

However, in the case of a trust or institution established before 1.4.1962, the exemption would not be forfeited merely on the ground that a part of the income or property of the trust or institution is applied directly or indirectly for the benefit of the specified persons if such use or application is for compliance with a mandatory term of the trust or a mandatory rule governing the institution.

For purposes of the disallowance of exemption, the ‘specified persons’ are the following namely:

(i) the author of the trust or the founder of the institution,

(ii) any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds ₹ 25,000,

(iii) where the author, founder or other substantial contributor is a Hindu Undivided Family, any member of the family,

(iv) any trustee of the trust or manager, by whatever name called, of the institution,

(v) any relative of such author, founder, person, member, trustee or manager, referred to above, and

(vi) any concern in which any of the above mentioned persons has a substantial interest.
The expression ‘relative’ used for this purpose has been defined in the Explanation (1) to Section 13 to mean:

(i) the spouse of the individual,
(ii) brother or sister of the individual,
(iii) the brother or sister of the spouse of the individual,
(iv) any lineal ascendant or descendant of the individual,
(v) any lineal ascendant or descendant of the spouse of the individual, and
(vi) the spouse of any of the persons referred to in (ii) to (v) above and any lineal ascendant or descendant of a brother or sister of either the individual or the spouse of the individual.

The income or the property of the trust or institution or any part thereof shall be deemed to have been used or applied for the benefit of the specified persons and consequently the trust will forfeit its exemption from income-tax in the following cases specified in Section 13(2):

(i) Where any part of the income or property of the trust or institution is, or continues to be lent to any of the specified persons for any period during the previous year without either adequate security or adequate interest or both;

(ii) If any land, building or other property of the trust or institution is or continues to be made available for the use of any of the specified persons for any period during the previous year without charging adequate rent or other compensation;

(iii) If any amount is paid by way of salary, allowance or otherwise during the previous year to any of the specified persons out of the resources of the trust or institution for service rendered by that person to such trust or institution and the amount so paid is in excess of what may reasonably be paid for such service;

(iv) If the services of the trust or institution are made available to any of the specified persons during the previous year without adequate remuneration or other compensation;

(v) If any security, share or other property is purchased by or on behalf of the trust or institution from any of the specified persons during the previous year for a consideration which is more than adequate;

(vi) If any share, security or other property is sold by or on behalf of the trust or institution to any of the specified persons during the accounting year for a consideration which is less than adequate;

(vii) If any income or property of the trust or institution is diverted during the previous year in favour of any of the specified persons. However, if the total value of the income and/or property so diverted does not exceed ₹ 1,000 in value, the trust will not forfeit the exemption merely because any portion of the income or property of the trust is diverted for the benefit of any of the specified persons; and
(viii) If any funds of the trust or the institution are, or continue to remain, invested for any period during the accounting year in any concern in which any of the specified persons has a substantial interest.

For purposes of disallowance of the exemption to a charitable trust or institution the specified persons shall be deemed to have a substantial interest in a concern under the following circumstances:

(i) **In case where the concern is a company** - if its equity shares carrying not less than 20% of the total voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of the other specified persons, or

(ii) **In the case of any other concern** - if such specified persons are entitled individually or jointly to not less than 20% of the profits of such concern at any time during the relevant accounting year.

Where the trust funds are invested in a concern in which any of the specified persons has a substantial interest and the quantum of the investment does not exceed 5% of the capital of the concern, the exemption shall not be allowed in respect of the income arising from such investment and the remaining income will continue to enjoy exemption from tax.

Further for debentures of an Indian company/Corporation acquired by the trust/institution after 28 February, 1983 but before 25th July, 1991, the exemption from tax under Section 11 or Section 12 shall be allowed to the trust/institution in respect of interest on such debentures if the trust/institution disinvests such debentures latest by 31st March, 1992.

Any charitable or religious trust or institution will forfeit exemption from tax if any funds of the trust or institution are invested or deposited, after February 28, 1983, otherwise than in any one or more of the modes specified in Section 11(5). Such trusts and institutions will also forfeit exemption from tax if any part of their funds invested before March 1, 1983 otherwise than in any one or more of the forms or modes specified in Section 11(5) continue to remain so invested or deposited after November 30, 1983. Trusts or institutions which continue to hold any shares in a company (other than a Government company or a statutory corporation) after the said date will also forfeit exemption from income-tax.

The aforesaid provisions will, however, not apply in relation to assets which constituted the original corpus of the trust or institution as on June 1, 1973 and any accretion to the assets being shares of a company forming part of the corpus of the trust or institution as on June 1, 1973, where such accretion arises by way of bonus shares. The aforesaid provisions will also not apply in relation to assets (being debentures issued by a company) acquired by the trust/institution before March 1, 1983. Further, it will not apply in relation to any asset [other than an investment or deposit in the mode or form as specified in Section 11(5)] which is held after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st Day of March, 1993 whichever is later in the mode and form as specified in Section 11(5). Also, it will not apply in relation to any funds representing the profits and gains of business relevant to the assessment year 1984-85 or any subsequent year.
Notwithstanding anything contained in Sub-section (1) or Sub-section (2), but without prejudice to the provisions contained in Sub-section (2) of Section 12, in the case of a charitable or religious trust running an educational institution or a medical institution or a hospital, the exemption under Section 11 or Section 12 shall not be denied in relation to any income, other than the income referred to in Sub-section (2) of Section 12, by reason only that such trust has provided educational or medical facilities to persons referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3).

If the trust or institution has any other income in addition to profits and gains of business, for getting exemption under this clause separate books of account in respect of such business are to be maintained.

**Business income of charitable trusts:** The exemption from income-tax will not be denied to any religious or charitable trust in respect of profits or gains of business, provided that:

(a) the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or is of a kind notified by the Government, or

(b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution and, separate books of account are maintained by the trust/institution of such business.

As per Section 13(7), nothing contained in Section 11 or 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donation referred to in Section 115BBC on which tax is payable in accordance with the provisions of that section.

**4.96 Conditions as to Registration of Trusts, etc. (Section 12A)**

The provisions of Sections 11 and 12 shall not apply in relation to any trust or institution unless the following conditions are fulfilled:

(a) The person in receipt of the income has made an application for registration of the trust or institution in the prescribed form and manner with the Chief Commissioner or Commissioner of Income-tax before 1st day of July, 1973 or before the expiry of a period of one year from the date of creation of the trust or the establishment of the institution whichever is later;

However, as per a change in Section 12A done by Finance Act, 1999 on and from 1st June 1999 an application for registration of the trust or institution has to be made only to the Commissioner.

Where however, an application is made after the period as aforesaid the provisions of Sections 11 and 12 will apply from the date of the creation of the trust or the establishment of the institution if the commissioner is satisfied that the person in receipt of income was prevented from making an application for registration within the aforesaid period for sufficient reasons.
If however, the Commissioner is not satisfied, the provisions of Sections 11 and 12 will apply from the 1st day of the financial year (i.e. the previous year) in which the application is made.

(b) Where the total income of the trust or institution before giving effect to the provisions of Sections 11 and 12 exceeds fifty thousand rupees in any previous year and the accounts of the trust or the institution are audited by a chartered accountant and a copy of the auditors report in the prescribed form and verified in the prescribed manner is submitted alongwith the return of income for the relevant assessment year.

(c) Where the total income of the trust or institution as computed under this Act without giving effect to the provisions of Sections 11 and 12 exceeds one crore rupees in any previous year, the trust or institution:

(i) publishes its accounts in a local newspaper, before the due date for furnishing the return of income under Sub-section (4A) of Section 139; and

(ii) furnishes a copy of such newspaper along with such return.

Rule 17A of the Income-tax Rules, 1962 provides that an application for registration of a trust shall be made in duplicate in Form No. 10A and shall be accompanied by the following documents:

(i) where the trust is created or the institution is established under an instrument, the instrument in original together with a copy thereof and where it is created otherwise than under an instrument, the document evidencing the creation of the trust or the establishment of the institution together with one copy thereof. The Chief Commissioner or Commissioner may accept a certified copy instead of the original where the original cannot be conveniently produced.

(ii) where the trust is in existence during any year or years prior to the financial year in which the application for registration is made, two copies each of the accounts of the trust for the three years (immediately) preceding the years in which the application for which the accounts have been made-up.

In terms of Section 12AA, on receipt of application for registration, the Chief Commissioner or Commissioner shall call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf. Sub-section 12AA is amended by Finance Act, 1999 w.e.f. 1.6.99 so as to provide that an order on an application for registration of a trust or institution is to be made by the Commissioner only and not by the Chief Commissioner. He has to either grant or decline registration within six months from the end of the month in which the application was received. Also Sub-section (1A) is inserted in Section 12AA so as to provide that all applications pending before the Chief Commissioner on which no order has been made by him before 1st June, 1999 shall stand transferred from 1st June, 1999 to the Commissioner and the Commissioner may proceed with such application under Sub-section (1) from the stage at which it was on that day.
Where the commissioner is satisfied that the activities of the trust or institution are not genuine or are not carried out in accordance with the objects of the trust or institution then the commissioner may pass an order in writing for the cancellation of registration granted under section 12AA or under section 12A after giving an opportunity of being heard. (Inserted by the Finance Act, 2010, w.e.f. 1-6-2010.)

PART IV

4.97 TAX EXEMPTIONS TO POLITICAL PARTIES (SECTION 13A)

‘Political party’ means an association or body of individual citizens of India registered with the Election Commission of India as a political party and includes a political party deemed to be registered with that Election Commission of India.

Political parties are liable to pay tax on their income and they are assessed as ‘An association of persons’. However, the income derived by these parties as income by way of voluntary contributions, Income from House Property; and Income from Other Sources or Capital Gains are exempt from subject to the following conditions:

(i) the party keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce the income;

(ii) in respect of each such voluntary contribution in excess of ₹ 20,000, the party keeps and maintains a record of the contributions and names and addresses of the persons who have made such contribution; and

(iii) the accounts of the party are audited by a Chartered Accountant or other qualified accountant.

The Chief Executive Officer of the political party is required to file a return of income if the total income (computed under this Act without giving effect to the provisions of Section 13A) exceeds the maximum amount which is not chargeable to income-tax. In this connection, the provisions of Section 139(1) shall apply.

4.98 VOLUNTARY CONTRIBUTIONS RECEIVED BY AN ELECTORAL TRUST (SECTION 13B)

Any voluntary contributions received by an electoral trust shall not be included in the total income of the previous year of such electoral trust, if

(a) such electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951, during the said previous year, ninety-five per cent of the aggregate donations received by it during the said previous year along with the surplus, if any brought forward from any earlier previous year; and

(b) such electoral trust functions in accordance with the rules made by the Central Government.

‘Electoral Trust’ means a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government.
LESSON ROUND UP

- This chapter discusses the incomes enumerated under section 10 which are not included in the net total income of the assessee.
- This Chapter also deals with the special provisions with regard to newly established Industrial Undertakings in various regions.
- Moreover this chapter discusses about income from property held for trusts, charitable and religious purposes.
- It also deals with income of the political parties

SELF TEST QUESTIONS

1. Discuss the incomes which are neither included in total income nor is income-tax payable on them.

2. Discuss any three of the following incomes which do not form part of total income under the Income-tax Act, 1961:
   (i) Retrenchment compensation, (ii) Income of a Professional Association, (iii) Subsidy received from Tea Board, and (iv) Income of a Local Authority.

3. (a) State the provisions of the Income-tax Act, 1961 relating to exemption from income-tax of the following:
   (b) Define the following:
      (i) Charitable purpose (ii) Political Party.

4. State the conditions which are essential to support a claim for exemption of income of public charitable trust under Section 11 of the Income-tax Act,
5. Enumerate the privileges conferred on a foreign technician by the Income-tax Act, 1961 and the conditions to be fulfilled for eligibility of the concessions.

6. What are the provisions relating to exemption of income of a political party? Discuss.

7. What are the conditions to be satisfied to enable the Electoral Trust to claim full exemption?

8. What are the benefits available to a 100 per cent export oriented unit? Describe the eligibility conditions for availing such benefits under Section 10B of the Act.
COMPUTATION OF TOTAL INCOME UNDER VARIOUS HEADS

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 under which the income of an assessee falls to be charged. Since the rules for computing income and the permissible deductions vary with different heads of income, each of the heads is dealt with separately in different sections of the Act. In short, Section 4(1) charges total income; Section 5 defines its range; Section 14 classifies it; Sections 15 to 59 quantify.

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).

This chapter covers the following topics/concepts and the chapter is divided into four parts:

Part I : Computation of Income from Salaries

- Salary [Section 17(1)]
- Allowances
- Perquisites [Section 17(2)]
  (A) Tax-free perquisites (in all cases)
  (B) Taxable perquisites (in all cases)
  (C) Perquisites taxable only in the cases of Specified Employees
- Valuation of Perquisites
- Rent-free/Concessional rent residential accommodation [Rule 3(1)]
- Sweeper, Gardener, Watchman or a Personal Attendant (Sub-rule 3)
- Gas, Electric Energy or Water (Sub-rule 4)
- Profits in Lieu of or in Addition to Salary
**Deductions Allowed from Salaries (Section 16)**

- Provident funds - Treatment of Contributions to and Money Received from the Provident Fund
- Incomes exempt from Tax and not includible in ‘Salary’
- Performa of Computing Taxable Salary
- Illustrations

**Part II : Income from House Property**

- Basis of Charge
- Annual Value
- Computation of Net Annual Value
- Deductions from Income from House Property (Section 24)
- Loss from House Property
- Illustrations
- Exemptions

**Part III : Income from Business or Profession**

- ‘Business’ or ‘Profession’
- Income Chargeable To Income-Tax (Section 28)
- Profits and Losses of Speculation Business
- How Profits and Gains Are Computed
- Computation of Profits of Business or Profession Rules for Adjustment of Profit and Loss Account prepared by the Assessee
- Deductions Allowable
  - (a) Rent, Rates, Taxes, Repairs and Insurance for buildings (Section 30)
  - (B) Repairs and Insurance of Machinery, Plant and Furniture (Section 31)
  - (C) Depreciation (Section 32)
  - (D) Tea/Coffee/Rubber Development Account (Section 33AB)
  - (E) Site restoration fund [Section 33ABA]
  - (F) Reserves for Shipping Business (Section 33AC)
  - (G) Expenditure on Scientific Research (Section 35)
  - (H) Expenditure on Acquisition of Patent Rights or Copyrights (Section 35A)
  - (I) Deduction in respect of expenditure on know-how (Section 35AB)
  - (J) Expenditure on telecom licence (Section 35ABB)
  - (K) Expenditure on Eligible projects or schemes (Section 35AC)
  - (L) Expenditure of capital nature incurred in respect of specified business (Section 35AD)
  - (M) Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes (Section 35CCA)
  - (N) Expenditure by way of Payment to Associations and Institutions for carrying out Programmes of Conservation of Natural Resources (Section 35CCB)
  - (O) Amortisation of Preliminary Expenses (Section 35D)
  - (P) Amortisation of Expenditure in the case of Amalgamation/Demerger (Section 35DD)
  - (Q) Amortization of Expenditure in the case of Voluntary Retirement Scheme (Section 35DDA)
(R) Deduction in respect of Expenditure on Prospecting etc. for certain Minerals (Section 35E)
(S) Other Deductions
(T) Other Expenses not covered by the Previous Deductions
- Certain Allowable Losses
- Expenses Restricted/Disallowed
- Restriction on contribution by employers to non-statutory funds [Sections 40A(9), (10) and (11)]
- Disallowance of unpaid statutory liability (Section 43B)
- Deemed Profits
- Special Provision for Deductions in the Case of Business for Prospecting etc. for Mineral Oil (Section 42)
- Special Provisions Consequential to the Changes in the Rate of Exchange of Currency
- Special Provision for Computation of Cost of Acquisition of Certain Assets (Section 43C)
- Special Provision in Case of Income of Public Financial Institutions, etc. (Section 43D)
- Insurance Business
- Special Provisions for Deduction in the Case of Trade, Professional or Similar Associations
- Maintenance of Accounts (Section 44AA)
- Compulsory Audit of Accounts of Certain Persons Carrying on Business or Profession
- Provision for Computing Profits and Gains of Business of Civil Construction etc. (Section 44AD)
- Special Provisions for Computing Profits and Gains of Business of Plying, Hiring or Leasing Goods Carriages
- Special Provisions for Computing Profits and Gains of Retail Business (Section 44AF)
- Special Provisions for Computing Profits and Gains of Shipping Business in The Case of Non-Residents (Section 44B)
- Deduction of Head Office Expenditure in the Case of Non-Residents (Section 44C)
- Computation of Income by way of Royalty etc. in case of Foreign Companies (Section 44D)

Part IV : Income from Capital Gains
- Capital Gains
- Capital Asset
- Transfer
- Transfer in the previous year
- Gain on Transfer
- Distribution of assets by companies in liquidation (Section 46)
- Short-term and long-term capital gains
- Zero Coupon Bonds
- Computation of capital gain in certain cases
- Mode of computation and deductions
- Indexed Cost of Acquisition
- Indexed Cost of Improvement
- Cost Inflation Index specified for purpose of computation of capital gains
- Determination of Indexed Cost of Acquisition
- Meaning of cost of acquisition [Section 55(2)]
- Cost of assets acquired on liquidation of a company
- Cost of Securities
- Advance money received
- Cost of improvement (Assessment Year 2000-01) [Section 45(1A)]
- Computation of Capital Gains on purchase by company of its own shares or other specified securities (w.e.f. Assessment Year 2000-01)
- Capital gains exempt from tax
- Profit on sale of property used for residence (Section 54)
- Transfer of land used for agricultural purposes (Section 54B)
- Compulsory acquisition of lands and buildings (Section 54D)
- No tax on long-term capital gains if investments made in specified bonds (Section 54EC)
- Capital gain on the transfer of certain capital assets not to be charged in case of investment in residential house (Section 54F)
- Capital gain on shifting of industrial undertaking from urban area (Section 54G)
- Exemption of capital gain on transfer of assets of shifting of industrial undertaking from urban area to a Special Economic Zone [Section 54GA]:
- Extension of time for acquiring new asset or depositing or investing amount of capital gain (Section 54H)
- Bonus shares and capital gains
- Computation of capital gains in respect of depreciable assets (Section 50)
- Cost of acquisition and capital gain in case of depreciable assets of electricity companies [Section 50A]
- Special provisions for computation of capital gains in case of slump sale [Section 50B]
- Computation of capital gain in real estate transaction [Section 50C]
- Reference to Valuation Officer (Section 55A)

**Part V : Income from other sources**

- Income chargeable under the head _Income from other Sources_
- Taxation of Dividends
- Meaning of the term _Dividend_ [Section 2(22)]
- Deductions allowable in computing income from other sources
- Amounts not Deductible (Section 58)
- Interest on Securities [Section 56(2)(id)]
- Tax Concessions.
PART I: INCOME FROM SALARY

5.1 Computation of Income from Salaries

Under Section 15 the income chargeable to income tax under the head salaries in the case of any employee would include:

Any salary due to an employee from an employer or a former employer during the previous year irrespective of the fact whether it is paid or not.

Any salary paid or allowed to the employee during the previous year by or on behalf of an employer, or former employer, would be taxable under this head even though such amounts are not due to him during the accounting year.

Arrears of salary paid or allowed to the employee during the previous year by or on behalf of an employer or a former employer would be chargeable to tax during the previous year in cases where such arrears were not charged to tax in any earlier year.

However it would not include:

- Any salary paid in advance and included in the total income of any person for any previous year, shall not be included again in the total income of the person when the salary becomes due.

- Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as “salary” for the purposes of this section.

Due Basis of Taxation

The basis of taxation of income from salary is normally on ‘due’ basis. Thus, salary due to an employee is taxable regardless of the fact whether he actually receives it or not. Exceptions to this rule are of cases where salary is received in advance by an employee which is chargeable to tax as and when it is received although the salary is not due to him. But in order to ensure that there is no double taxation of the same item of income in the hands of the same employee, the explanation to Section 15 specifically provides that where an item of a salary income received by an employee in advance is taxed as and when it is received, it shall not again be charged to tax when it becomes due to the assessee. In order to attract liability to tax under this head, it is not essential that the employee who is liable to tax under this head, must receive salary from his present employer.

Salary received from former employer

Even salaries received by an employee from former employer(s) for services rendered would be chargeable to tax under this head. Hence, the fact that the employee in question is not an employee under the person from whom the money is received at the time of its receipt, is irrelevant. Arrears of salaries are chargeable to tax as the income of the year in which such arrears are received if they are not charged to tax at the time of becoming due.
Income in the form of Fees

For instance, if an employee is given promotion in January 1982 with retrospective effect from 1-4-1979, the additional income of the employee arising to him by virtue of the promotion for the period from 1-4-1979 till January 1982 would become taxable as income due to him in January 1982. Consequently, this entire amount of arrears would be taxable as the income of the financial year 1981-82. In cases where an employee receives salaries for more than 12 months in any financial year on account of any salary being paid to him in advance or in arrears, he would be entitled to get relief under Section 89(1) of the Act by spreading the income over the earlier years in accordance with Rule 21A of the Income-tax Rules.

Salary income is also assessed as the income of the financial year, i.e., from April 1 to next March 31. But the salary of an employee is a separate source, distinct from other classes of income. The basis of liability under the head salaries is the employer-employee relationship. Before charging the particular income received by a person under this head, care must be taken to ensure that there exists such a relationship of employer and employee between the recipient and the payer of the income. The question whether a particular person receives the income in his capacity as an employee or not has to be decided from the facts of each case.

For instance, the professor of university would be receiving income by way of monthly salary from the university which is chargeable to tax under this head. But this does not mean that every item of income received by the employee from his employer would be taxable under this head. Thus, income by way of examinership fees received by a professor from the same university in which he is employed would not be chargeable to tax under this head but must be taxed as Income from other sources under Section 56. This is because of the fact that the essential condition that the income in question must be received for services rendered in the ordinary course of employment would not be fulfilled in the case of examinership fees.

Likewise, a director of a company may, in some cases, be an employee of a company where there is a specific contract of employment between him and the company. The fact that the same person has dual capacity in his relationship with the company does not mean that he cannot be taxed under this head. Every item of income arising to such a director who is also an employee of the company (e.g. a managing director or other whole-time director) by virtue of his employment would be taxable as his income from salary. Thus, income by way of remuneration received by a managing director would be taxable as his salary income whereas the income received by him as director’s fees in his capacity as director for attending the meetings of the Board would be assessable under the head ‘Income from other sources’.

An official liquidator appointed by the Court or by the Central Government would also become an employee of the Central Government under Section 448 of the
Companies Act, 1956 and consequently the remuneration due to him would also be assessable under the head ‘Salaries’.

Remuneration received by a manager of a company even if he is wrongly designated as a director or by any other name would be chargeable to tax under this head regardless of the fact that the amount is payable to him monthly or is calculated at a certain percentage of the company’s profits.

Income from other Sources

The income received by a treasurer of a bank would be taxable as his salary income if the treasurer is an employee of the bank. If he does not happen to be an employee, the income received by him would be taxable as ‘Income from other sources’.

For this purpose, the question whether in a particular case the treasurer is an employee or not has to be decided on the basis of the facts and circumstances of each case having due regard to his powers, responsibilities and functions. Income derived by any person from carrying on a profession or vocation must be taxed as business income and not as salary income because employment is different from profession.

But, if an employee receives any money from his employer as part of the terms of employment for not carrying on any profession, such income must be taxed as salary income. For instance, the allowance given by employer to a doctor employed by him for not carrying on a profession in addition to the employment, would be income arising from employment in accordance with the terms and conditions of such employment and must, therefore, be taxed as salary income. If an employee gets money from persons other than his employer and if such money is not in any way related to the contract of services with the employer under whom he is working, the receipts, if taxable as income, must be assessed under the head ‘Income from other sources’.

However, gratuity, bonus, commission or other items of payment made by the employer without any specific stipulation in the contract of employment to this effect, would still be taxable as salary, because they are paid by the employer for the services rendered by the employee. The fact that such payments are voluntary and in certain circumstances may qualify for exemption from income-tax in the hands of the employee, would not affect the income being computed under the head salary.

Tax-Free Remuneration

Any personal gifts received by the employee from his own employer on account of the personal regard or love and affection which the employer has for his employee or gift made by the employer to his employee on the occasions of his birthday, marriage or other such occasions, would be totally exempt from tax because such receipts are not in consideration of the services rendered by the employee.

Any lump sum amount paid to an employee by his employer in commutation, reduction or substitution of salary, pension or other type of income from employment, is nevertheless taxable as income from salary in the year in which such payment falls due or is received by the employee, whichever is earlier. Section 200 of the
Companies Act totally prohibits any company from paying tax-free remuneration to any of its employees.

**Exemption from Taxation**

For purposes of computing the income taxable under this head, the gross salary due to the employee should be taken as the basis. Thus, any tax deducted at source or other deductions on account of provident fund, insurance premium, or on any other account made by the employer from the salary income, should be added to the net salary received by the employee. The fact that some of the deductions like provident fund or insurance premium may qualify for any deduction from gross total income in the personal assessment of the employee, does not, in any way, affect the quantum of salary income due to the employee.

Any salary voluntarily surrendered by the employee on or after 1-4-1961 to the Central Government under the provisions of the Voluntary Surrender of Salaries (Exemption from Taxation Act), 1961, would not be treated as income taxable in the hands of the employee. In all other cases, the salary foregone voluntarily or otherwise surrendered by the employee, would still be chargeable to tax although the employee may not receive that income. No tax exemption is available for surrender of salaries for the simple reason that the amount surrendered constitutes merely an application of income which is immaterial for the purpose of taxing the employee.

If the foregoing or surrender of salary represents a donation for charitable purpose, the employee may qualify for deduction from gross total income under Section 80G of the Act. However, salary foregone before it becomes due cannot be taxed [C.I.T. v. Mehar Singh Sampuran Singh Chawla (1973) 90 ITR 219]. Further, where in reality there is no agreement to pay any salary, the apparent foregoing of a fictional salary would not attract tax.

Where a person, out of missionary spirit, agrees to work as principal in an institution without accepting any salary from the institution, and in the school accounts his salary is shown as an item of expenditure, while the same amount is entered in the receipts as a donation by the management in a separate cash book meant for exclusive use for the management only, these entries are book entries only and no money is actually paid to him; hence, taking into consideration the special circumstances of the case, the fictional salary would not be taxable [Reade v. Brearley (1933) 17 TC 687].

**Taxable Payment**

Salary is taxable even if the money is not received or could not be recovered from the employer due to his insolvency or any other reason. The expenses, if any, incurred by the employee to take legal proceedings against his employer for its recovery would not also be allowed as a deduction from the income assessable in his hands. This is because of the fact that the actual receipt of the income is immaterial for purpose of its taxation.

It is immaterial whether the employer is Government or a private employer. Further, the salary may be paid by a foreign Government to its employees serving in India, the salary is taxable under the head “Salaries”. However, the leave salary paid
to the legal heirs of the deceased employee in respect of privilege leave standing to
the credit of such employee at the time of his/her death is not taxable as salary. It is
an exgratia payment on compassionate grounds in the nature of gift. Thus, the
payment is not in the nature of a salary (Letter from C.B.D.T. dated 5-11-1965 and
circular No. 309 dated 3-7-1981).

Non-Taxable Payment

According to a circular of the Board dated 22-5-1967, the salary received by a
person as Member of Parliament will not be chargeable to income-tax under the head
―Salaries" but as ―Income from other sources" because a Member of Parliament is not
an employee of the Government but only an elected representative of the people.

Also, as decided in the following cases, the payments made by the employer to
his employee/s, are not taxable as ―Salary" :

— A payment made on an employee's transfer to compensate him for loss
suffered on sale of his house - Hochstrasser v. Mayes (1959) 3 AER 817
(HL).

— A payment in appreciation of personal qualities - Copper v. Blakiston (1907)
5 TC 347 (CA).

— A grant made to a retiring director not because he was a director but as a
personal gift - Benyon v. Thorpe (1928) 14 TC 1.

— Payment made as a gift in appreciation of personality and character of
employee - David Mitchell v. CIT (1956) 30 ITR 701 (Cal.).

However, in the following cases, the payments made have been held as forming
part of salary and chargeable to tax under the head :

— Incentive bonus received by employees of LIC, and, the expenses incurred
on earning such bonus are not allowed as deduction - K.A. Chowdary v. CIT
(1989) 44 Taxman 472 (AP).

— Interest income in excess of permissible limit (i.e. @12%) credited to the P.F.
account of an employee, is to be treated as ‘Salary’ for purposes of Sections
15 and 16 - M.C. Muthanna v. CIT (1989) 43 Taxman 163/177 ITR 501
(Mad).

— Dearness allowance, city compensatory allowance, house rent allowance
and other allowances form part of salary of salaried employees - Karnataka
Electricity Board Employees' Union v. Union of India (1989) 46 Taxman
45/179 ITR 521 (Kar.).

— Dearness allowance is taxable as part of salary only when form part of
retirement benefit salary otherwise not - Brooke Bond Employees Union v.
Union of India (1989) 46 Taxman 203/179 ITR 533 (Pat.).
5.2 Salary [Section 17(1)]

-Salary“ includes:

(i) Wages or Salary: ‘Salary’ is generally used in respect of payment for services of a higher class, whereas ‘wages’ is confined to the earnings of labourers. However, for income-tax purposes there is no difference between salary and wages.

(ii) Annuity is annual grant made by the employer to the employee.

(iii) Pension is a periodical payment for past services.

(iv) Gratuity is a lump sum payment for past services. The amount of gratuity received is not taxable. (For details see ‘Exempted incomes’).

(v) Fees and Commission: It is a remuneration to encourage employees.

(vi) Perquisites: These include all benefits and amenities provided by the employer to the employee, either in cash or kind.

(vii) Profit in lieu of or in addition to salary or wages.

(viii) Advance of Salary.

(viii) Any payment received by an employee in respect of any period of leave not availed of by him.

(ix) Taxable portion of annual accretion: Where the employee is a member of a Recognised Provident Fund, the amount contributed by the employer in this fund in excess of 12 per cent of the salary of the employee and interest credited on the amount of the fund in excess of the prescribed rate of interest (12% on or after April 1, 1986) is to be included in the salary income.

(x) Taxable portion of transferred balance: When an unrecognised provident fund is recognised for the first time, the balance in the unrecognised provident fund is known as ‘Transferred balance”. The employer’s share (contribution in unrecognised provident fund and interest on employer’s share) is included in the salary income for income-tax purposes at the time of such transfer.

(xi) The contribution made by the Central Government in the previous year, the account of any employee under a pension scheme referred to in Section 80CCD.

Test Your Knowledge

1. Yana is an employee of Tara Pvt. Ltd. getting a salary of ₹40,000 per month which becomes due on 1st of next month and is paid on the 7th of the next month. Salary for which months will be taxable for the assessment 2012-13?

Solution: The salary for the months of March 2011 to February 2012 will be taxable for the assessment year 2012-13 because salary for March 2011 was due on 1st April 2011 and salary for March 2012 will be due on 1st April 2012.
(1) Advance salary is taxable on receipt basis in the previous year in which it is received. The recipient can, however, claim relief under Section 89(1) read with Rule 21A.

(2) Arrears salary is taxable on receipt basis subject to the fact that it has not been taxed on accrual basis earlier. The recipient can claim relief in terms of Section 89(1) read with Rule 21A.

(3) Encashment of leave salary (before retirement) is taxable on receipt basis but relief can be claimed under Section 89(1). However, such salary received at the time of retirement is exempt subject to Section 10(10AA).

(4) Pension received by a person from the employer after his retirement is taxed as salary. The pension can be either uncommuted or commuted. Commuted pensions received by government employees are wholly exempt under Section 10(10A). In case of non-Government employees, commuted value of one-third of pension which he is normally entitled to receive is exempt from tax if the employee receives gratuity. In other cases, one-half of commuted value of pension is exempt.

(5) Instalments re-paid under Additional Emoluments (C.D.) Act, 1974 are taxable as arrear of salary in the previous year in which the same are received. However, relief under Section 89(1) can be claimed.

5.3 Allowances:

An allowance is defined as a fixed amount of money given periodically in addition to the salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employment. It is taxable on due/accrued basis whether it is paid in addition to the salary or in lieu thereon. These allowances are generally taxable and are to be included in the gross salary unless a specific exemption has been provided in respect of allowances provided under the following sections:

(a) House Rent Allowances – Section 10(13A): Covered under study III.

(b) Special Allowance – Section 10(14)(i) & (ii)

5.3.1 Fully Taxable Allowances- The below mentioned allowances are fully taxable:

(1) Dearness Allowance, Additional Dearness Allowance and Dearness Pay: This is a very common allowance these days on account of high prices. Sometimes Additional Dearness Allowance is also given. It is included in the income from salary and is taxable in full. Sometimes it is given under the terms of employment and sometimes without it. When it is given under the terms of employment it is included in salary for purposes of determining the exemption limits of house rent allowance, recognised provident fund, gratuity and value of rent free house and is also taken into account for the purposes of retirement benefits.

Sometimes dearness allowance is given as ‘Dearness Pay’. It means that it is being given under the terms of employment.

(2) Fixed Medical Allowance: It is fully taxable.
(3) **Tiffin Allowance**: It is given for lunch and refreshments to the employees. It is taxable.

(4) **Servant Allowance**: It is fully taxable even if it is given to a low paid employee, not being an officer, i.e., it is taxable for all categories of employees.

(5) **Non-practising Allowance**: It is generally given to those medical doctors who are in government service and they are banned from doing private practice. It is to compensate them for this ban. It is fully taxable.

(6) **Hill Allowance**: It is given to employees working in hilly areas on account of high cost of living in hilly areas as compared to plains. It is fully taxable, if the place is located at less than 1,000 metres height from sea level.

(7) **Warden Allowance and Proctor Allowance**: These allowances are given in educational institutions for working as Warden of the hostel and/or working as Proctor in the institution. These allowances are fully taxable.

(8) **Deputation Allowance**: When an employee is sent from his permanent place of service to some other place or institution or organisation on deputation for a temporary period, he is given this allowance. It is fully taxable.

(9) **Overtime Allowance**: When an employee works for extra hours over and above his normal hours of duty he is given overtime allowance as extra wages. It is fully taxable.

(10) **Other Allowances** like Family allowance, Project allowance, Marriage allowance, City Compensatory allowance, Dinner allowance, Telephone allowance etc. These are fully taxable.

5.3.2 **Allowances not fully taxable**:

(a) **Special allowances for performance of official duty [section 10(14)(i)]**: These allowances are specifically granted to meet expenses wholly and exclusively incurred in the performance of official duty. These are exempt to the extent such expenses are actually incurred or the amount received whichever is less. These allowances are Travelling allowance, Daily allowance, Helper allowance, Academic Allowance, Uniform Allowance etc. All these allowances are discussed in detail under study III.

(b) **Allowance to meet personal expenses**:

— Allowances which are granted to meet personal expenses are exempt to the extent of amount received or the limits specified whichever is less. These allowances are Children education allowance, Hostel Expenditure allowance, Tribal area, Schedule area/agency area allowance, special compensatory hilly area allowance or high altitude allowance etc., Border area, remote area allowance or disturbed area allowance etc., Compensatory, modified field area allowance, Counter insurgency allowance granted to members of armed forces, Transport allowance etc. These allowances are discussed in detail in Study III.

— allowances which are granted to meet personal expense are exempt to the
fixed percentage of amount received. These allowances are allowed to transport employees working in any transport system.

5.3.3 Treatment of Entertainment Allowance:

In case of Entertainment allowance an assessee will not get any exemption but would be eligible for deduction u/s 16(ii) from gross salary. The deduction is allowed to government employees only; Non-Government employees will not be eligible for this deduction. The entire amount of entertainment allowance will be added to gross salary.

The minimum of the following shall be available as deduction in case of Government employees:

(i) Actual amount of entertainment allowance received during the year
(ii) 20% of his salary exclusive of any allowance, benefit or other perquisites.
(iii) ₹5,000.

5.4 Perquisites [Section 17(2)]

The term "perquisites" includes all benefits and amenities provided by the employer to the employee in addition to salary and wages either in cash or in kind which are convertible into money. These benefits or amenities may be provided either voluntarily or under service contract. For income-tax purposes, the perquisites are of three types:

(A) Tax-free perquisites
(B) Taxable perquisites
(C) Perquisites taxable under specified cases.

(A) Tax-free perquisites (in all cases)

The value of the following perquisites is not to be included in the salary income of an employee:

(i) Medical Facilities:
   (a) The value of any Medical facility provided to an employee or his family member in any hospitals, clinics, etc. maintained by the employer.
   (b) Reimbursement of expenditure actually incurred by the employee on medical treatment for self or for his family members in any hospitals, dispensaries etc. maintained by the Government or local authority or in a hospital approved under the Central Health Scheme or any similar scheme of the state Government or in a hospital, approved by the chief commissioner having regard to the prescribed guidelines for the purposes of medical treatment of the prescribed diseases or ailments.
   (c) Group medical insurance obtained by the employer for his employees (including family members of the employees) or all medical insurance payments made directly or reimbursement of insurance premium to such employees who take such insurance.
   (d) Reimbursement of medical expenses actually incurred by the employee upto a maximum of ₹ 15,000 in the aggregate in a year, in a private
hospital for his and his family.

(e) Any expenditure incurred or paid by the employer on the medical treatment of the employee or any family member of the employee outside India, the travel and stay abroad of such employee or any family member of such employee or any travel or stay abroad of one attendant who accompanies the patient in connection with such treatment will not be included in perquisites of the employee. However, the travel expenditure shall be excluded from the perquisites only when the employee’s gross total income as computed before including the said expenditure does not exceed two lakh rupees and further to such conditions and limits as the Board may prescribe having regard to guidelines, if any, issued by the Reserve Bank of India.

(ii) **Refreshment:**
The value of refreshment provided by the employer during office hours and in office premises is fully exempt. Free Meals provided by the employer during working or business hours or through paid non transferable (usable only at eating joints) voucher if its value thereof in either case does not exceed ₹50 will not be treated as income of the employee. However, free meals provided by the employer during working hours in a remote area or an offshore installation shall be fully exempt.

(iii) **Subsidised lunch or dinner provided by employer:**
With effect from assessment year 1996-97, expenditure incurred by employer on provision of food or beverages to employees either inside or outside the place of work during working hours upto ₹ 35 per day per employee will not be treated as income of the employee provided the amount is paid by the employer directly to the caterer, restaurant, eating place, canteen, etc. (Circular: Nos. 708, dated 18.7.1995 and 727, dated 27.10.1995 issued by CBDT).

(iv) **Recreational facilities:**
The value of recreational facilities provided is exempt. However, the facility should not be restricted to a selected few.

(v) **Telephone facility** provided at the residence of the employee is exempt to the extent of the amount of telephone bills paid by the employer when it is used for official and personal purposes of the employee.

(vi) **The value of transport** provided by the employer to the employees as a group (and not to any individual or a few employees alone) from their place of residence to the place of work and back in the case of an employer engaged in the business of carriage of goods or passengers, to his employees either free of charge or at a concessional rate. Also from the assessment year 1990-91, conveyance facility provided for the journey between office and residence and back at free of charge or at concessional rate.

(vii) **Personal accident insurance:** Payment of annual premium by employer on personal accident policy effected by him to his employee.

(viii) **Refresher Course:** Where the employee attends any refresher course in management and the fees are paid by the employer, the amount spent by employer for the purpose.
Free rations: The value of free rations given to the armed forces personnel.

Family planning: The amount spent by an employer on the promotion of family planning amongst its employees.

Sale of an asset (being a movable asset but other than car, electronic items) or gift of such asset to an employee after using the same by the employer for 10 years or more is a perquisite in the hands of employee.

Perquisites to Government employees posted abroad.

Rent-free house to High Court Judges [High Court Judges (Conditions of Service) Act, 1954].

Rent-free house to Supreme Court Judges [Supreme Court Judges (Conditions of Service) Act, 1958].

Conveyance facility to High Court and Supreme Court judges.

Privilege passes and privilege ticket orders granted by Railways to its employees.

Sum payable by an employer through a Recognised Provident Fund or an Approved Superannuation Fund or Deposit-linked Insurance Fund established under the Coal Mines Provident Fund or the Employees' Provident Fund.

Sum payable by an employer to pension or deferred annuity scheme.

Employer's contribution to staff group insurance scheme.

Actual travelling expenses paid/reimbursed by the employer for journeys undertaken by employees for business purposes.

Leave travel concession exempt as per provision of Section 10.

Free holiday trips to non-specifed employees.

Rent-free furnished residence (including maintenance thereof) provided to an Officer of Parliament, a Union Ministry and a leader of opposition in Parliament.

Goods sold to employees, by their employer, at concessional rates.

The value of any benefit provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under the Employees' Stock Option Plan or Scheme of the said company.

Free educational facility to the children of the employee in an educational institute owned/maintained by the employer if cost of such education or value of such benefit does not exceed 1,000/- per month per child.

Interest free loan to an employee if the amount of loan does not exceed 20,000/-. computers/laptops (provided only for use, ownership is retained by the employer).

One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payment to which the employee has no right till the contingency occurs.
(B) Taxable perquisites (in all cases)

The value of the following perquisites is added to the salary income of the employee:

(i) Value of rent-free residential accommodation provided to the assessee (except to the Judge of a High Court or Supreme Court; an Officer of Parliament, a Union Minister and a leader of opposition in Parliament).

(ii) Value of any concession in the matter of rent in respect of residential accommodation provided to the assessee.

(iii) Sum paid by the employer (directly or indirectly) for effecting an assurance on the life of the employee or for providing an annuity. If the amount is paid to a recognised provident fund or an approved superannuation fund, or to a deposit linked insurance fund established under the Coal Mines Provident Fund Act or Employees' Provident Fund Act, the sum so paid is not to be included in the salary income.

(iv) Sum paid by the employer in respect of any obligation of the assessee, which would otherwise have been payable by the assessee. Some of the examples of such expenses are as follows:

(a) Income-tax paid by the employer due from the employee.

(b) Payment of club bills, club subscription or hotel bills of the employee.

(c) Fees paid by the employer directly to the school or reimbursement of tuition fees of the children of the employee.

(d) Payment of any loan due to the employee.

(v) The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.

(a) "specified security" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme;

(b) "sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;

(c) the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from the assessee in respect of such security or shares;

(d) "fair market value" means the value determined in accordance with the method as may be prescribed;

(e) "option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price;
(vi) The amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds one lakh rupees;

(vii) The value of any other fringe benefit or amenity as may be prescribed.

Some other examples of taxable perquisites are as follows:

(a) Any reward awarded. For example, a professional jockey receives present from his employer on winning the race.

(b) Any legal charges incurred by the employer to save or defend the employee. For instance, if an employee knocks down a pedestrian during the course of employment or otherwise while driving the company's car due to his negligence and, to defend his case in the court, the employer incurs heavy expenses, the amount spent by him on this account would represent a perquisite. It is likely that the actual expenditure incurred by the employer might be much larger than what the employee himself would have done if he were to take up the proceedings himself. Even in such cases, the perquisite chargeable to tax would be the entire amount spent by the employer and not only a portion thereof which the employee would have spent if he had himself taken up the legal proceedings in the court. Thus, the cost of legal defence of a criminal charge or civil litigation expenses incurred by the employer on behalf of the employee even in his own interest for the purpose of retaining the services of the employee would be taxable as perquisite.

(C) Perquisites taxable only in the cases of Specified Employees

The value of certain benefit or amenity granted or provided free of cost or at a concessional rate in any of the following cases only shall be included in the salary income:

(a) by a company to an employee who is director thereof [It is immaterial whether the director is full time or part time director];

(b) by a company to an employee, being a person who has a substantial interest in the company, i.e., employee is the beneficial owner of at least 20 per cent of the equity shares of that company;

(c) an employee whose income chargeable under head salaries (exclusive of the value of all benefits or amnuties not provided by way of monetry payments) exceed ₹ 50,000, is a specified employed.

Some of the examples of such expenses which are included in the salary income of a specified employee as defined above are:

(i) Free boarding facility provided by employer.

(ii) Free conveyance for private use.

(iii) Free education facility to the family members of employee.

(iv) Holiday trips at employer’s cost.

(v) Gas, electricity or water supplied free for household consumption.

(vi) Wages of domestic servants paid by employer.

(vii) Free lunches or dinners.
Note: From 1.4.1990 the use of any vehicle provided by a company or an employer for journey by the assessee from his residence to his office or other place of work, or from such office or place to his residence, shall not be regarded as a benefit or amenity granted or provided to him free of cost or at concessional rate for the purpose of computation of perquisite.

Valuation of Perquisites

The basic principles governing valuation of perquisites are as follows:

— The valuation is done on the basis of their value to the employee and not the employer's cost for providing the same - Wilkins v. Rogerson (1963) 49 ITR 395 (CA).

— The value of perquisite is included in the salary income only if the perquisite is actually provided to the employee.

— Perquisite which is not actually enjoyed by the employee (though the terms of employment provide for the same) cannot be valued and taxed in the employee's hands. Therefore, where the employee waives his right of perquisite, he cannot be taxed thereon.

The valuation of various perquisites is done as follows:

### Rent-free/Concessional rent residential accommodation [Rule 3(1)]

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Circumstances</th>
<th>Where the accommodation is unfurnished</th>
<th>Where the accommodation is furnished</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>Where the accommodation is provided by Union or State Government to their employees either holding office or post in connection with the affairs of Union or the State or serving with any body or undertaking under the control of such Government on deputation.</td>
<td>License fee determined by Union or State Government in respect of accommodation in accordance with the rules framed by that government as reduced by the rent actually paid by the employee.</td>
<td>The value of perquisite as determined under col. 3 and increased by 10% p.a. of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air conditioning plant or equipment) or if such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year.</td>
</tr>
<tr>
<td>(2)</td>
<td>Where the accommodation is provided by any other employer and (i) 15% of salary in cities having population exceeding 25 lakh as per 2001 census.</td>
<td>(i) 15% of salary in cities having population exceeding 25 lakh as per 2001 census.</td>
<td>The value of perquisite as determined under col. 3 and increased by 10% p.a. of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air conditioning plant or equipment) or if such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year.</td>
</tr>
</tbody>
</table>
(a) where the accommodation is owned by the employer, or
(b) Where the accommodation is taken on lease or rent by the employer.

(ii) 10% of salary in cities having population exceeding ₹10 lakh but not exceeding ₹25 lakh as per census of 2001,
(iii) 7.5% of salary on other cities, in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee.

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(3) Where the accommodation is provided by the employer specified in Sl. (1) or (2) above in a hotel (except where the employee is provided such accommodation for a period not exceeding in aggregate 15 days on the transfer from one place to another)</td>
<td>Not applicable</td>
<td>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.</td>
</tr>
</tbody>
</table>

Provided that nothing contained in this sub-rule would be applicable to any accommodation located in a ‘remote area’ provided to an employee working at a mining site or an onshore oil exploration site, or a project execution site or an accommodation provided in an offshore site of similar nature.

Provided further that where on account of his transfer from one place to another, the employee is provided with accommodation at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower value with reference to the Table above for a period not exceeding 90 days and there after the value of perquisite shall be charged for both such accommodations in accordance with the Table.
Sweeper, Gardener, Watchman or a Personal Attendant (Sub-rule 3)

The value of benefit to the employee or any member of his household resulting from the provision of the employer of services or a sweeper, a gardener, a watchman or personal attendant, shall be the actual cost to the employer. The actual cost in such a case shall be the total amount of salary paid or payable by the employer or any other person on his behalf for such services as reduced by any amount paid by the employee for such services.

Gas, Electric Energy or Water (Sub-rule 4)

The value of benefit to the employee resulting from the supply of gas, electric energy or water for his household consumption shall be determined as the sum equal to the amount paid on that account by the employer to the agency supplying the gas, electric energy or water. Where such supply is made from the sources owned by the employer, without purchasing them from any other outside agency, the value of perquisites would be the manufacturing cost per unit incurred by the employer. Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value so arrived at.

Free or Concessional Education (Sub-rule 5)

The value of benefit to the employee resulting from the provision of free or concessional educational facilities for any member of his household shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf of where the educational institution is itself maintained and owned by the employer or where free educational facilities for such member of employees’ household are allowed in any other educational institution by reason of his being in employment of that employer, the value of the perquisite to the employee shall be determined with reference to the cost of such education in similar institution in or near the locality. Where any amount is paid or recovered from the employee on that account, the value of benefit shall be reduced by the amount so paid or recovered.

Provided that where the educational institution itself is maintained and owned by the employer and free educational facilities are provided to the children of the employee or where such free educational facilities are provided in any institution by reason of his being in employment of that employer, nothing contained in this sub-rule shall apply if the cost of such education or the value of such benefit per child does not exceed ₹ 1,000 p.m.

Other fringe benefits or amenities (Sub-rule 7)

In terms of provisions contained in sub-clause (vi) of Sub-section (2) of Section 17, the following other fringe benefits or amenities are hereby prescribed and the value thereof shall be determined in the manner provided thereunder;

(i) Interest free or concessional loan

The value of the benefit to the assesse resulting from the provision of interest-free or concessional loan made available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the simple interest computed at the
rate charged by the State Bank of India in respect of loans for house and conveyance and at the rate charged by the State Bank of India for other loans on the maximum outstanding monthly balance as reduced by the interest, if any, actually paid by him or any such member of his household.

However, no value would be charged if such loans are made available for medical treatment in respect of diseases specified in rule 3A of these rules or where the amount of loans are petty not exceeding in the aggregate ₹ 20,000.

Provided that where the benefit relates to the loans made available for medical treatment referred to above the exemption so provided shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.

(ii) Use of any movable asset

The value of benefit to the employee resulting from the use by the employee or any member of his household of any movable asset (other than assets already specified in this rule and other than laptops and computers) belonging to the employer or hired by him shall be determined @ 10% p.a. of the actual cost of such asset or the amount of rent or charge paid or payable by the employer, as the case may be, as reduced by the amount, if any, paid or recovered from the employee for such use.

(iii) Transfer of any movable asset

The value of benefit to the employee arising from the transfer of any movable asset belonging to the employer directly or indirectly to the employee or any member of his household shall be determined to the amount representing the actual cost of such asset to the employer as reduced by the cost of normal wear and tear calculated at the rate of 10% of such cost for each completed year during which such asset was put to use by the employer and as further reduced by the amount, if any, paid or recovered from the employee being the consideration for such transfer.

Provided that in the case of computers and electronic items, the normal wear and tear would be calculated at the rate of 50% and in the case of motor cars at the rate of 20% by the reducing balance method (WDV).

Explanation to the Rule 3

Meaning of certain terms mentioned in rules for valuation of perquisites:

(i) “accommodation” includes a house, flat, farm house or part thereof, or accommodation in a hotel, model, service apartment, guest house, caravan, mobile home, ship or other floating structure;

(ii) “entertainment” includes hospitality of any kind and also expenditure on business gifts other than free samples of the employer own product with the aim of advertising to the general public;

(iii) “hotel” includes licensed accommodation in the nature of motel, service apartment or guest house;
“member of household” shall include:

(a) spouse(s)
(b) children and their spouses
(c) parents
(d) servants and dependants;

“remote area”, for the purposes of proviso to this sub-rule means an area that is located at least 40 kilometers away from a town having a population not exceeding 20,000 based on latest published all-India census;

“salary” includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called from one or more employers, as the case may be but does not include the following, namely:

(a) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
(b) employer's contribution to the provident fund account of the employee;
(c) allowances which are exempted from payment of tax;
(d) the value of perquisites specified in clause (2) of section 17 of the Income-tax Act;
(e) any payment or expenditure specifically excluded under proviso to sub-clause (iii) of clause (2) or proviso to clause (2) of section 17;

“maximum outstanding monthly balance” means the aggregate outstanding balance for each loan as on the last day of each month.

5.5 Profits in Lieu of or in Addition to Salary

Under this the following items are included:

(A) **The amount of any compensation due** to or received by an assessee from the employer or former employer at or in connection with the termination of his employment. The ‘termination of employment’ means retirement, premature termination of employment, termination by death or voluntary resignation. Generally, under the Income-tax Act, the income that is chargeable to tax is only a receipt which is revenue in nature; receipts of a capital nature are not chargeable to tax but this provision constitutes an exception to this rule because compensation received by an employee for termination of his employment would be a capital receipt since it is received in replacement of the sources of income itself. Still it is chargeable to tax because of the specific provision in the Act. However, relief under Section 89(1) would be available to the assessee in cases where he gets money which represents a profit in lieu of salary.

The amount of any compensation due to or received by any assessee from his employer in connection with the modification of the terms and conditions relating to employment. For example, where an employer wants to cut down the salary payable to the employee, the lump sum paid to compensate the employee shall be treated as profits in lieu of salary. In the same way, where the remuneration for services is paid at the end of the period of employment or a lump sum remuneration is paid at the
beginning of employment for a number of years, such payment shall be treated as
profits in lieu of salary.

Any other payment due to or received by an assessee from his employer or
former employer. However, value of personal gifts is not to be included in the salary.

Any amount due to or received, whether in lump sum or otherwise, by any
assessee from any person - (A) before his joining any employment with that person;
or (B) after cessation of his employment with that person.

This provision has been inserted by the Finance Act, 2001, with effect from April
1, 2002, i.e. from assessment year 2002-03 onwards. The object of this provision is
to bring to tax any amount due to or received, whether in a lump sum or otherwise, by
an assessee from his employer before joining employment or after cessation of such
employment as income of the assessee under the head —salaries—.

(B) Any payment from the provident or other fund (not being an approved
superannuation fund) to the extent of employer’s share and interest thereon.

(C) Gratuity

Exceptions : The following shall not be included in the salary income:

(a) Death-cum-retirement gratuity received under:
   (i) The Revised Pension Rules of the Central Government;
   (ii) The Central Civil Services (Pension) Rules, 1972;
   (iii) Any similar scheme applicable to the employees of Central, State or
        local authority;
   (iv) The pension code or regulations applicable to the members of the
defence services.

(b) Any gratuity received under the payment of Gratuity Act, 1972 to the extent it
does not exceed an amount calculated in accordance with the provisions of Sub-
sections (2) and (3) of Section 4 of that Act.

(c) Any other gratuity received by an employee on his retirement, or on his
becoming incapacitated or on termination of his employment or received by nominee
on his death to the extent of half month’s salary for each completed year of service
calculated on the basis of the average salary for the ten months immediately
preceding the month in which any such event occurs, subject to such limit
(₹10,00,000 on retirement, death or termination on or after 24.05.10 vide notification
no. 43/2010 dated 11.06.2010. Prior to this the limit was ₹3,50,000) as the Central
Government may notify having regard to the limit applicable in that behalf to the
employees of that Government.

Note: For details see ‘Exempted Income’ in Study Lesson II.

(D) Commuted value of pension

(a) In case of Government employees (Central, State, Local authority or
statutory corporation), the full amount of commuted value of pension is
exempted.
(b) In case of non-Government employees, the exemption is as follows:

(i) where the employee receives any gratuity, the commuted value of one-third of the pension which he is normally entitled to receive;

(ii) where the employee does not receive any gratuity, the commuted value of one-half of such pension.

(E) Compensation received by a workman under the Industrial Disputes Act, 1947 or any other Act or rules, orders or notifications issued thereunder or under any standing orders or under any award, contract of service or otherwise to the extent of the actual award or ₹ 50,000, or the amount notified by the Central Government, whichever is less.

(F) Amount received from Statutory Provident Fund and/or Public Provident Fund.

(G) Amount received from a Recognised Provident Fund

The amount is exempt if the following conditions are satisfied:

(i) he has rendered a continuous service with his employer for five years or more; or

(ii) if he has not rendered such continuous service, the service has been terminated by reason of his ill health, or discontinuance or contraction of employer's business or any other cause beyond the control of employee; or

(iii) on cessation of his employment, he obtains employment with any other employer and balance standing in his Recognised Provident Fund is transferred to his account in the Recognised Provident Fund maintained by the new employer.

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

(H) House rent allowance received from the employer. The exempted amount shall not exceed:

(a) actual amount of such allowance received in respect of the relevant period; or

(b) excess of rent paid or payable by the employee over ten per cent of salary (salary includes dearness allowance, if the terms of employment so provide, (and also commission if based on percentage on sales/turnover) but excludes all other allowances and perquisites) due in respect of the relevant period; or

(c) an amount equal to -

(i) Where such accommodation is situated at Mumbai, Calcutta, Delhi or Chennai, 50% of the amount of salary due to the assessee in respect of the relevant period; and
(ii) Where such accommodation is situated at any other place, 40% of the amount of salary due to the assessee in respect of the relevant period; whichever is the least.

(I) Remuneration for extra duties and voluntary payments to employees made by an employer, if such payments are made in reference to services rendered by virtue of employment, also constitutes profits in lieu of salary.

Note: For details, see "Exempted Income" in Study II.

5.6 DEDUCTIONS ALLOWED FROM SALARIES (SECTION 16)

The following amounts shall be deducted in order to arrive at the chargeable income under the head 'Salaries'.

(A) **Standard deduction**: Omitted by Financial Act, 2005 w.e.f. 1.4.2006. – Section 16(i)

(B) **Entertainment allowance**: Where the employee is in receipt of entertainment allowance, the amount so received shall first be included in the salary income and thereafter the following deduction shall be made - Section 16(ii):

16(ii). A deduction in respect of any allowance in the nature of an entertainment allowance specifically granted by an employer to the assessee who is in receipt of a salary from the Government, a sum equal to one-fifth of his salary (exclusive of any allowance, benefit or other perquisite) or five thousand rupees, whichever is less.

W.e.f. April 1, 2002 entertainment allowance will be allowed in computing income from salary only in case of employees of the Government and will cease to be allowable for persons other than those employed in Government i.e. entertainment allowance deduction will not be allowed to other employees.

Note: For this purpose 'Salary' excludes any allowance, benefit or other perquisites:

Where an employee, not entitled to claim deduction under this clause, spends some money on the entertainment of customers of the concern, the amount so spent cannot be deducted from the salary income. The condition makes exemption well-nigh impossible for the employees of private sector. For them, the better course would be to get the entertainment expenses reimbursed.

(C) **Tax on employment or Professional Tax**: From the assessment year 1990-91, deduction shall be allowed in respect of any sum paid by the assessee on account of a tax on employment within the meaning of clause (2) of article 276 of the Constitution, leviable by a State under any law passed by its legislature.

5.7 PROVIDENT FUNDS - TREATMENT OF CONTRIBUTIONS TO AND MONEY RECEIVED FROM THE PROVIDENT FUND

For purposes of Income-tax, provident funds are grouped under three heads:

(A) **Statutory provident fund**: All provident funds which are set up under the Provident Funds Act, 1925 are called Statutory Provident Funds. Provident funds of institutions such an Universities, Colleges or other Educational Institutions, Reserve Bank of India, State Bank of India, the Central Government and State Government
would constitute Statutory Provident Funds. In case of Statutory Provident Fund, the entire amount of employer's contribution without any limit or restriction whatsoever and the interest thereon received by the employee shall not be includible in the total income of the employee both at the time when the contribution is made and at the time when the money is received by or on behalf of the employee on his retirement, death or otherwise. This exemption is specifically conferred by Sub-section (11) of Section 10 of the Income-tax Act. The employee can contribute to this fund out of his salary as much as he likes.

(B) Recognised provident fund: All Provident Funds recognised by the Commissioner of Income-tax under Rule 3 of Part 'A' of the Fourth Schedule to the Income-tax Act, 1961 and also Provident Funds established under a scheme framed under the Employees Provident Funds Act, 1952 are known under the Income-tax Act as Recognised Provident Funds. For the purposes of being treated as Recognised Provident Fund, the Fund in question must be recognised by the Commissioner of Income-tax at the time of its setting up and must continue to be so recognised even subsequently. The moment the recognition is withdrawn by the Commissioner, the Fund ceases to be a Recognised Provident Fund. The Provident Funds of various Public Sector Undertakings, Semi-Government bodies and other institutions and organisations including companies which are recognised by the Commissioner for income-tax purposes, would be treated as Recognised Provident Funds. In the case of a Recognised Provident Fund, the employer's contribution to the Provident Fund is not treated as the employee's income so long as the contribution by the employer does not exceed 12% of the salary of the employee. But if the contribution of the employer exceeds 12% of the employee's salary, the excess of the contribution over 12% of the salary of the employee is to be treated as part of the taxable income from salaries in the hands of the employee in respect of the financial year in which the contributions were made by the employer. The fact that the employee concerned does not receive the money in hand nor is he entitled to get the money immediately does not in any way affect the taxability of the excess over 12% of the employee's salary. The employee's own contribution qualifies for rebate from income-tax under Section 88 of the Income-tax Act. The qualifying amount would be a sum equal to the amount actually contributed by the employee or one-fifth of the salary whichever is less in that previous year. [Salary for this purpose, includes basic salary; dearness allowance/pay (if the terms of employment so provide) and commission (if based on a fixed percentage of turnover achieved by the employee)]. As regards interest on the contributions to the Provident Fund, only an amount exceeding a sum calculated at 12% per annum on the balance standing to the credit of the employee would be treated as part of the taxable income of the employee. In other words, so long as the amount of interest does not exceed this limit, the interest does not become chargeable to tax in the hands of the employee.

(C) Unrecognised provident Fund: The Provident Fund which is neither Statutory nor recognised by the Commissioner of Income-tax nor Public Provident Fund, would be an Unrecognised Provident Fund for income-tax purposes. In the case of an Unrecognised Provident Fund, the employee's own contribution to the Fund would not be allowed as a deduction. The employer's contribution and the interest thereon would, however, be exempt from tax as and when the contributions are being made. But when the money in lump sum is received back by the employee, that part of the amount attributable to the employer's contribution would be taxable as
income from salaries and the interest on the employer's contribution would also be taxable as salary income in the hands of the employee. The employee's own contributions when received back would not be taxable because they do not contain an element of income. However, the interest thereon would be chargeable to tax as income from other sources and not as income from salaries.

5.8 INCOMES EXEMPT FROM TAX AND NOT INCLUDIBLE IN 'SALARY'

The following items relevant to salaries have been discussed under 'Exempted Incomes' at Study Lesson II of this material and are exempt from tax, subject to the limits applicable for each:

1. Leave Travel Allowance [Section 10(5)];
2. Remuneration of a person who is not a citizen of India [Section 10(6)];
3. Allowances payable outside India [Section 10(7)];
4. Remuneration of an employee working under the Co-operative Technical Assistance Programme [Section 10(8)];
5. Death-cum-retirement gratuity [Section 10(10)];
6. Amount received in commutation of Pension [Section 10(10A)];
7. Encashment of earned leave [Section 10(10AA)];
8. Retrenchment compensation [Section 10(10B)];
9. Payment received from Statutory Provident Fund [Section 10(11)];
10. Payment received from a recognised Provident Fund [Section 10(12)];
11. Payment received out of an approved Superannuation Fund [Section 10(13)];
12. House rent allowance [Section 10(13A)];
13. Special allowances to meet the expenses of the duties [Section 10(14)];
14. Salary income of a member of Scheduled Tribe [Section 10(26)];
15. Salary income of a resident of Ladakh [Section 10(26A)];

For details see Income-tax Study II.

Salaries payable by an employer are chargeable to tax in the hands of the employee and are subject to deduction of tax at source under Section 192 of the Income-tax Act. The obligation of the employer to deduct tax at source is mandatory and cannot be negotiated. But in cases where there is any failure on the part of the employer to deduct the tax at source, the employee cannot escape liability to tax; he would be chargeable to tax on his entire income from salaries. The fact that the employer could be proceeded against and be subjected to penalty or prosecution, would not absolve the employee of his liability to pay tax on the income which should have been subjected to deduction of tax by the employer. In every case, the tax deducted by the employer should be added to the employee's income and the gross amount should be taken as the taxable income of the employee.

Proforma of Computing Taxable Salary

Salary ..... 
Dearness allowance or Dearness pay .....
Bonus
Commission
Pension
Employer’s contribution in excess 12% to R.P.F.
Interest in excess of 8.5% on Recognised Provident Fund
Taxable Allowances
Taxable portion of partially exempted allowances
Perquisites (after proper valuation)
Taxable part of gratuity
Taxable part of commutation of pension
Lump-sum received from Unrecognised Provident Fund to the extent of Employer’s contribution and interest on Provident fund
Taxable part of Compensation received
Gross Salary

Less:
(i) Entertainment Allowance
(ii) Employment Tax/Professional Tax

Taxable Salary

5.9 ILLUSTRATIONS

Illustration 1:

Calculation of taxable house rent allowance:
Mr. Ram is employed at Bombay. His basic Salary is ₹ 5,000 per month. He receives ₹ 5,000 p.a. as house rent allowance. Rent paid by him is ₹ 12,000 p.a. Find out the amount of taxable house rent allowance.

Answer:
As per Rule 2A, the least of the following is exempt from tax:
(i) the actual house rent allowance;
(ii) excess of rent paid over 10% of salary;
(iii) where the accommodation is situate at Bombay, Delhi, Calcutta or Madras, one-half of the amount of salary due to the assessee for the relevant period;
(iv) Where the accommodation is situate at any other place, two-fifth of the salary due to the assessee for the relevant period.

Accordingly, Mr. Ram would be entitled to the least of:
(i) ₹ 5,000 or
(ii) ₹ 6,000 being excess of rent over 1/10th of salary; or
(iii) ₹ 30,000 (being one-half of the salary of the assessee).

₹ 5,000, being the least, would not be included in the total income of Mr. Ram. So the entire amount of HRA would be exempt from tax.

Salary for this purpose includes basic salary as well as dearness allowance if the
terms of employment so provide. It also includes commission based on a fixed percentage of turnover achieved by an employee as per terms of contract of employment but excludes all other allowances and perquisites and these are determined on due basis for the period during which rental accommodation is occupied by the employee in the previous year.

Illustration 2:

Valuation of rent free unfurnished accommodation:

Mr. Shyam, employed at Mumbai, receives the following from his employer during the previous year:

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
</tr>
<tr>
<td>Bonus</td>
</tr>
<tr>
<td>Entertainment allowance (taxable)</td>
</tr>
<tr>
<td>Electricity expenses</td>
</tr>
<tr>
<td>Professional tax paid by the employer</td>
</tr>
</tbody>
</table>

Rent free house (owned by Employer):

Fair rent   48,000
Salary of gardener  2,400
Garden Maintenance  1,200
Salary of watchman  1,800

Determine the value of taxable perquisites in respect of rent free house assuming
(a) Mr. Shyam is a Government Officer and the fair rent as arrived at by the Government is ₹ 6,000 p.a
(b) Mr. Shyam is a semi-Government employee,
(c) Mr. Shyam is employed by a private company.

Solution:

(a) If Mr. Shyam is a Government Officer: As per Rule 3(1) of Income-tax Rules, ₹ 6,000 p.a being the rent of the house as per Government rules, will be the taxable value of the perquisite.

(b) If Mr. Shyam is a semi-Government employee: As per Rule 3(1) of the Income-tax Rules, the value of the perquisite in respect of rent free accommodation is taken at 15% of salary of the employee (as the house is owned by the Employer and provided in Mumbai).

Salary = 67,800 (₹ 60,000 + 1,800 + 6,000)
15% of salary = 10,170 and
Therefore, ₹ 10,170 is taxable value of the perquisite.

Further, the value of Electricity expenses and Professional Tax paid by the employer, being perquisites, are not included in the salary for valuation of Rent Free House Accommodation.

(c) If Mr. Shyam is employed in Private Company: The value of perquisite in this case shall also be ₹ 10,170. Under the new rules there is no difference between the semi-Govt. and other employees.
Illustration 3:
Mr. Ramamoorthy, an employee of M/s. Gopalkrishnan & Co. of Chennai receives during the previous year ended March 31, 2012 the following payments:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
<td>40,000</td>
</tr>
<tr>
<td>Dearness allowance</td>
<td>3,000</td>
</tr>
<tr>
<td>Leave Salary</td>
<td>5,400</td>
</tr>
<tr>
<td>Professional tax paid by employer</td>
<td>1,000</td>
</tr>
<tr>
<td>Fair rent of the flat provided by employer</td>
<td>6,000</td>
</tr>
<tr>
<td>Rent paid for furniture</td>
<td>1,000</td>
</tr>
<tr>
<td>Rent recovered by employer</td>
<td>3,000</td>
</tr>
<tr>
<td>Contribution to Statutory Provident Fund</td>
<td>4,000</td>
</tr>
<tr>
<td>Employer’s contribution to Statutory Provident Fund</td>
<td>4,000</td>
</tr>
</tbody>
</table>

Compute his taxable income for the Assessment Year 2012-13.

Solution:

Computation of taxable income of Mr. Ramamoorthy for the Assessment Year 2012-13

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Pay</td>
<td>40,000</td>
</tr>
<tr>
<td>Dearness allowance</td>
<td>3,000</td>
</tr>
<tr>
<td>Leave salary</td>
<td>5,400</td>
</tr>
<tr>
<td>Professional tax paid by employer</td>
<td>1,000</td>
</tr>
<tr>
<td>Perquisite for House :</td>
<td></td>
</tr>
<tr>
<td>15% of salary (₹ 40,000 + 3,000 + 5,400)</td>
<td>7,260</td>
</tr>
<tr>
<td>Add: Furniture rent</td>
<td>1,000</td>
</tr>
<tr>
<td>Less: Rent recovered</td>
<td>(–) 3,000</td>
</tr>
<tr>
<td></td>
<td>54,660</td>
</tr>
<tr>
<td>Less: Professional tax u/s 16</td>
<td>1,000</td>
</tr>
<tr>
<td>Gross Total Income</td>
<td>53,660</td>
</tr>
<tr>
<td>Less: Tax deduction under Section 80C</td>
<td>4,000</td>
</tr>
<tr>
<td>Tax on total income</td>
<td>49,660</td>
</tr>
<tr>
<td>Total tax payable</td>
<td>NIL</td>
</tr>
</tbody>
</table>

Note: Assumed that dearness allowance forms part of the salary for the purpose of computation of superannuation or retirement benefits.

Illustration 4:

Raman, an employee of the Gas Supply Ltd., Agra, receives the following emoluments during the previous year 2011-12.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic pay</td>
<td>10,000</td>
</tr>
<tr>
<td>Project allowance</td>
<td>1,800</td>
</tr>
<tr>
<td>Arrears of project allowance of May, 1983</td>
<td>150</td>
</tr>
</tbody>
</table>
Professional tax paid by the employer  200
Rent free furnished house
— Fair rent of the house  2,000
— Rent of furniture  500
Free gas supply  400
Service of sweeper  600
Services of gardener  1,000
Service of cook  800
Free lunch  2,400

Free use of chauffeur driven Fiat car which is used partly for official and partly for private purposes.

He is a member of recognised provident fund to which he contributes ₹ 1,500. His employer also contributes an equal amount. He deposits ₹ 600 per month in 10 year account under the Post Office Savings Bank (CTD) Rules. Determine his taxable income and tax payable thereon for the assessment year 2012-13. (a) If Raman is a director in the employer company and the rent-free house is owned by it, (b) If Raman is neither a director nor a shareholder in the employer company and the rent-free house is not owned by it.

Solution:

His taxable income will be computed as under:

<table>
<thead>
<tr>
<th>If Raman is a director and rent-free house is owned by the company (A)</th>
<th>If Raman is neither a director nor a shareholder and rent-free house is not owned by the company (B)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1)</strong></td>
<td><strong>2)</strong></td>
</tr>
<tr>
<td>₹</td>
<td>₹</td>
</tr>
<tr>
<td>Basic Pay</td>
<td>10,000</td>
</tr>
<tr>
<td>Project allowance</td>
<td>1,800</td>
</tr>
<tr>
<td>Arrears of project allowance of May, 1983</td>
<td>150</td>
</tr>
<tr>
<td>Professional tax paid by the employer</td>
<td>200</td>
</tr>
<tr>
<td>Rent free furnished house :</td>
<td></td>
</tr>
<tr>
<td>— 15% of Salary</td>
<td>1,770</td>
</tr>
<tr>
<td>— Rent of furniture</td>
<td>500</td>
</tr>
<tr>
<td>Free gas supply</td>
<td>400</td>
</tr>
<tr>
<td>Service of sweeper</td>
<td>600</td>
</tr>
<tr>
<td>Service of gardener</td>
<td>1,000</td>
</tr>
<tr>
<td>Service of cook</td>
<td>800</td>
</tr>
<tr>
<td>Free lunch</td>
<td>Nil</td>
</tr>
</tbody>
</table>
Excess of employer's contribution towards provident fund over 12% of salary (1,500 - 12% of ₹ 10,000) 300 300

<table>
<thead>
<tr>
<th>Gross salary</th>
<th>18,110</th>
<th>15,310</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income from Salary</td>
<td>18,110</td>
<td>15,310</td>
</tr>
<tr>
<td>Tax on total income</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Notes:

1. It is assumed that the arrears of project allowance are taxable on receipt basis.
2. Perquisite in respect of Rent Free house is taxable in the hands of all the assessee. In this case fair market value has no relevancy (w.e.f. AY 2002-03) and assumed that the house is owned by the employer. Since the house is provided in Agra, population is assumed as exceeding ₹ 25 lakhs. Salary for valuation of perquisite is (₹ 10,000 + ₹ 1,800).
3. The free sweeper, gardener, cook, lunch, car etc. are not taxable in the second case, because Raman does not fall in the category of specified employee under Section 17(2)(iii) of the Act i.e., he is neither a director nor his salary is ₹ 50,000 p.a. or more.
4. Free lunch provided is not taxable to the extent of ₹ 50 per day.
5. Since Raman is employed in a Gas supply company, the value of gas supplied is taxable as cost to the employer. And it is assumed that the cost of supply is same as ₹ 400 as given.

Illustration 5:

For the year ended 31.3.2012, B receives a salary of ₹ 91,000 and conveyance allowance of ₹ 24,000. He is also provided with accommodation at Mumbai at concessional rent. The monthly rent of the accommodation is ₹ 7,500 of which ₹ 5,000 is paid by the employer. The balance of ₹ 2,500 is paid by B. B’s contribution to employee’s provident fund account is ₹ 7,592 and he pays ₹ 10,298 as life insurance premia. His expense on conveyance for official purposes was ₹ 22,500 for the year. Compute B’s tax liability for the assessment year 2012-13 assuming that he has no other income.

Solution:

Assessment year : 2012-13
Name of Assessee : Mr. B

Statement of Total income

<table>
<thead>
<tr>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
<td>91,000</td>
</tr>
<tr>
<td>Conveyance allowance</td>
<td>24,000</td>
</tr>
<tr>
<td>Less : Amount exempt under Section 10(14) (800 x 12)</td>
<td>9,600</td>
</tr>
<tr>
<td></td>
<td>14,400</td>
</tr>
</tbody>
</table>
Perquisite value of accommodation provided
at concessional rent  Nil
Gross Salary  1,05,400
Net Income from Salary  1,05,400
Less : Deduction under Section 80C (7,592 + 10,298)  17,890
Total Income  87,510
Nil
Tax liability

Note: Salary for the purpose of calculation of perquisite value of accommodation
provided at concessional rent is ₹ 91,000 + 14,400 = 1,05,400. The value of the
house perquisites shall be:

15% of salary  15,810
Less: Rent actually paid by B  30,000
Perquisite value  Nil

Illustration 6:

For the financial year 2011-12, A, a Central Government Officer receives salary
of ₹ 77,000 (including dearness allowance of ₹ 42,000) and entertainment allowance
of ₹ 18,000. His contribution to provident fund during this period is ₹ 7,200. In
addition, he has purchased National Savings Certificates (VIII Issue) for ₹ 6,000. He
has been provided with accommodation by the Government for which the rent
determined is ₹ 375 per month and this is recovered from A’s salary. Compute A’s tax
liability for the assessment year 2012-13 assuming that he has no other income.

Solution:

Name of assessee : Mr. A
Assessment Year : 2012-13
Status : Resident/Individual

<table>
<thead>
<tr>
<th>Statement of assessable income</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary from Central Government</td>
<td>77,000</td>
<td></td>
</tr>
<tr>
<td>Entertainment allowance</td>
<td>18,000</td>
<td>95,000</td>
</tr>
<tr>
<td>Less: Entertainment Allowance under Section 16(ii)</td>
<td>5,000</td>
<td>(-) 13,000</td>
</tr>
<tr>
<td>₹ 5,000 or [1/5th of salary exclusive of any allowance, benefit or perquisite (₹ 35,000)]</td>
<td>5,000</td>
<td>(-) 13,000</td>
</tr>
<tr>
<td>GROSS TOTAL INCOME</td>
<td>82,000</td>
<td></td>
</tr>
<tr>
<td>Less : Deduction under Section 80C (7,200 + 6,000)</td>
<td>13,200</td>
<td></td>
</tr>
<tr>
<td>Total Income</td>
<td>68,800</td>
<td></td>
</tr>
<tr>
<td>Tax liability</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Net tax payable</td>
<td>Nil</td>
<td></td>
</tr>
</tbody>
</table>
Illustration 7:

Mr. A, the General Manager of XYZ Ltd., retired on 31.12.2011 after 30 years of service.

The particulars of his income are as follows:
1. Salary ₹ 10,000 per month from January 1, 2011. House rent allowance ₹4,000 per month from January 1, 2011.
2. Medical expenses reimbursed by employer: ₹ 7,200 for the period from April 1, 2011 to December 31, 2011.
3. Mr. A and his family also availed LTC - they visited Mumbai and the expenses of ₹ 5,600 being the cost of air conditioned second class rail tickets was reimbursed by the employer.
4. The employer provides him a car for personal purposes and expenses are incurred by the employer amounting to ₹ 9,900.
5. Mr. A contributes 22% (12% regular and 10% additional voluntary contribution) to recognised provident fund and the company matches his regular contribution of 12%.
6. Mr. A has invested ₹ 20,000 in ULIP Scheme of UTI and ₹ 10,000 in public provident fund. He paid ₹ 8,000 towards life insurance premium on policy for a sum assured of ₹ 60,000.
7. He lives in his own house. The annual municipal value of the house is ₹ 15,000.
8. Payment of club bills to the extent of ₹ 2,700 for the year being monthly subscription @ 300 per month was reimbursed by the employer.
9. Mr. A received ₹ 1,50,000 as gratuity. He is not covered by the Payment of Gratuity Act.
10. He received ₹ 1,60,000 for encashment of leave, being 16 months' leave not availed of.

Compute A’s income for the assessment year 2012-13.

Solution:

<table>
<thead>
<tr>
<th>Name of the assessee</th>
<th>Mr. A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment year</td>
<td>2012-13</td>
</tr>
</tbody>
</table>

Computation of taxable income

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Salary (10,000 x 9)</td>
</tr>
<tr>
<td>HRA (4,000 x 9)</td>
</tr>
<tr>
<td>Payment of club bills (300 x 9)</td>
</tr>
<tr>
<td>Gratuity (See note 7)</td>
</tr>
<tr>
<td>Car facility</td>
</tr>
<tr>
<td>Encashment of leave (1,60,000 − 1,00,000)</td>
</tr>
<tr>
<td>(See note 8)</td>
</tr>
<tr>
<td>Gross salary income</td>
</tr>
<tr>
<td>Net salary income</td>
</tr>
</tbody>
</table>
(b) Income from house property (one self occupied house)
[wholly exempt under Section 23] NIL
Gross Total income 1,98,600
Less: Deduction under Section 80C
Less:
Qualifying Amount (QA) for deduction under Section 80C of the Act:
  PF contribution 19,800
  ULIP purchased 20,000
  Contribution in PPF 10,000
  Life Insurance premium 8,000
  Qualifying Amount: 57,800
Total Income 1,40,800
Tax payable 0
Add: Education cess @ 2% 0
Tax liability of Mr. A for assessment year 2012-13 0

Notes:
1. HRA is fully taxable as X lives in his own house.
2. Medical expenses reimbursed are not chargeable to tax to the extent of ₹15,000.
3. Reimbursement of rail fare (air conditioned second class) is exempt under Section 10(5) of the Act. Further, it is presumed that other conditions as laid down in Rule 2B of Income-tax Rules, 1962 are also satisfied.
4. Life insurance premium qualifies for deduction under Section 80C.
5. Notional income from one self occupied house is not chargeable to tax. Deduction of municipal taxes, insurance premium etc. in respect of such house is also not allowed.
6. Club bills are taxable unless the membership is primarily for the benefit of the employer. It is presumed in this case that it is not so.
7. Gratuity is exempt to the least of the following:
   (i) 1/2 month's salary for every completed year of service (calculated on the basis of average salary for 10 months preceding the retirement), 10,000 x 1/2 x 30 = 1,50,000.
   (ii) ₹ 10,00,000.
   (iii) Actual gratuity received ₹1,50,000.
8. Leave salary is exempt to the extent of the least of the following:
   (i) Salary in respect of unavailed leave at the time of retirement 1,60,000
   (ii) Salary for 10 months 1,00,000
   (iii) Limit of exemption as specified by the Government 3,00,000
(iv) Leave encashment actually received at the time of retirement 1,60,000

Exemption is limited to ₹ 1,00,000 being the least of the amounts mentioned above.

Illustration 8:

'A' furnishes the following details of his salary income for the financial year 2011-12:

(1) Salary 4,000 p.m.
(2) Dearness Allowance 500 p.m.
(3) Entertainment Allowance 200 p.m.
(4) Employer’s and his own contribution to unrecognised Provident Fund 2,600 each
(5) Interest on the accumulated balance of provident fund @ 12% p.a. 2,600
(6) City Compensatory Allowance 60 p.m.
(7) Medical Allowance 1,500 p.a.
(8) Project Allowance 600 p.m.
(9) He is also provided with an unfurnished accommodation for which his employer charges ₹ 200 p.m. The fair rent of house is ₹ 12,000 per annum. The house is owned by the employer.

Compute his taxable income from salary for the assessment year 2012-13.

Solution:

**Computation of taxable income of Mr. A from salary for the assessment year 2012-13.**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (₹ 4,000 x 12)</td>
<td>48,000</td>
</tr>
<tr>
<td>Dearnness allowance (₹ 500 x 12)</td>
<td>6,000</td>
</tr>
<tr>
<td>Entertainment allowance (₹ 200 x 12)</td>
<td>2,400</td>
</tr>
<tr>
<td>City Compensatory allowance (₹ 60 x 12)</td>
<td>720</td>
</tr>
<tr>
<td>Medical allowance</td>
<td>1,500</td>
</tr>
<tr>
<td>Project Allowance</td>
<td>7,200</td>
</tr>
<tr>
<td>Perquisite value of accommodation provided at concessional rent</td>
<td>6,573</td>
</tr>
<tr>
<td>Gross Salary</td>
<td>72,393</td>
</tr>
<tr>
<td>Net Income from Salary</td>
<td>72,393</td>
</tr>
</tbody>
</table>

Notes:

1. Employer’s and Mr. A’s own contribution to unrecognised Provident Fund and interest thereon is exempt from tax during the normal course of employment.
2. Fixed medical allowance is taxable.

3. Due to absence of any specific information about Mr. A’s residence, he has been treated as a resident of any place having population exceeding 25 lakhs.

4. Salary for the purpose of calculation of perquisite value of accommodation provided at concessional rent is ₹ 48,000 + 2,400 + 720 + 1,500 + 7,200 = 59,820. It is assumed that the house is owned by the employer. The value of house perquisite shall be

\[
\begin{align*}
\text{15\% of Salary} & \quad 8,973 \\
\text{Less: Rent actually paid by B} & \quad 2,400 \\
\text{Perquisite value} & \quad 6,573
\end{align*}
\]

**Illustration 9:**

Compute taxable salary income of Mr. Z of Kanpur for the assessment year 2012-13 based on the following information:

- Salary @ ₹ 4,000 p.m. (serving since 1.4.1995) 48,000
- Entertainment Allowance 5,000
- Bonus 10,000
- Dearness Allowance (not recognised for computing retirement benefit) 2,000
- Employer’s contribution to provident fund (recognised) 4,000
- Education Allowance for one child 2,700
- Lunch Allowance 7,200
- Rent-free unfurnished quarters (valued) 6,000
- Medical expenses met by employer 600
- Reimbursement of hotel bills (necessary for duty) 100
- Employee’s contribution to Provident Fund 2,000
- Premium of Mrs. Z’s life policy of ₹ 50,000 6,000
- Purchase of books necessary for duty 1,000
- Share of HUF 50,000

**Solution:**

**Computation of Salary Income of Mr. Z for the assessment year 2012-13**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (i.e. ₹ 4,000 x 12)</td>
<td>48,000</td>
</tr>
<tr>
<td>Entertainment Allowance</td>
<td>5,000</td>
</tr>
<tr>
<td>Bonus</td>
<td>10,000</td>
</tr>
<tr>
<td>Dearness Allowance</td>
<td>2,000</td>
</tr>
</tbody>
</table>
- Employer’s contribution to recognised provident fund (since it is not exceeding 12% of salary) Exempt
- Education allowance for one child 2,700
  Less: Exempt under Section 10(14):
  (1 x 100 x 12) (1,200) 1,500
- Lunch Allowance 7,200
- Valuation of rent free unfurnished quarters (value as given, because it being less than 20% of salary) 6,000
- Medical expenses met by employer Exempt
- Reimbursement of hotel bills (necessary for duty) Exempt

Gross Salary 79,700
Net Salary 79,700

Qualifying Amount for deduction under Section 80C of the Act:
(i) Mr. Z’s contribution to recognised provident fund 2,000
(ii) Premium of Mrs. Z’s life policy 6,000

Notes:
(1) Entertainment allowance is not exempt as per provisions of Section 16(ii) of the Act.
(2) Children Education allowance is exempt @ ₹100 per month per child up to maximum of two children as per provisions of Section 10(14) of the Act.
(3) Value of rent free unfurnished quarters shall be 15% of salary, assuming that the house is not owned by the employer. Salary for this purpose is ₹71,700 (i.e. ₹48,000 + 5,000 + 10,000 + 7,200 +1,500).
  — 15% of Salary ₹10,755
  — Value of quarters ₹6,000

Value of perquisite shall be lessor of above two (i.e. ₹6,000).
(4) Share from HUF is not taxable under section 10.

**DIFFERENT MEANINGS OF „SALARY‟ FOR DIFFERENT PURPOSES**

<table>
<thead>
<tr>
<th>For computation of taxable income under the head salaries</th>
<th>Rent-free House or Concession in rent</th>
<th>House Rent Allowance</th>
<th>Qualifying Amount of Contribution to R.P.F.</th>
<th>Entertainment Allowance</th>
<th>Gratuity</th>
<th>Determination of Rs. 50,000 regarding taxability of perquisites u/s 17(2)(iii)(c)</th>
<th>Compensation u/s 10(10B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Basic</td>
<td>1. Basic</td>
<td>1. Basic</td>
<td>Same as Basic</td>
<td>Basic</td>
<td>Basic</td>
<td>Salary,</td>
<td></td>
</tr>
</tbody>
</table>
salary or wages.
2. Advance salary.
3. Arrears of salary.
4. Annuity or pension.
5. Gratuity.
6. Fees, Commission, Bonus.
7. Allowances including Dearness Allowance.
8. Profits in lieu of salary.
10. Excess contribution to R.P.F. by employer over 12% of salary.
11. Excess interest received from R.P.F. over 8.5% rate of interest will be taxable.
12. Taxable portion of transferred balance to R.P.F.

PART II: INCOME FROM HOUSE PROPERTY

5.10 BASIS OF CHARGE

Section 22 of the Act provides as follows:

The annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head Income from House Property”.

The following points emerge from the above charging section:

(a) **Tax is charged on income from the buildings or lands appurtenant thereto**: The buildings include residential buildings, buildings let out for
business or profession or auditoriums for entertainment programmes. The location of the building is immaterial. It may be situated in India or abroad.

(b) **Tax is charged on income from lands appurtenant to buildings**: Where the land is not appurtenant to a building the income from land can be charged as business income or "income from other sources", as the case may be. The lands appurtenant to buildings include approach roads to and from public streets, courtyards, motor garage, compound, play-ground and kitchen garden. In case of non-residential buildings, car-parking spaces, drying grounds or play-grounds shall be the lands appurtenant to buildings.

(c) **Tax is charged from the owner of the buildings and land appurtenant thereto**: Where the recipient of the income from house property is not the owner of the building, the income is not chargeable under this head but under the head 'Income from Business or Other Sources'. For example, the income to a lessee from sub-letting a house or income to a mortgagee from house property mortgaged to him is not chargeable under the head 'Income from House Property'.

The owner of the buildings may be the legal owner or beneficial owner. In ownership, the ownership of building is considered and not the ownership of income. In certain cases the income may not be received by the owner of the building, still he shall be liable to tax because he is the owner of the building.

**Deemed ownership:**

As per section 27, the following persons though not the legal owners of a property are deemed to be the owners for the purposes of sections 22 to 26:

(i) **Transfer to a spouse or minor child**: an individual who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter;

(ii) **Holder of an impartible estate**: the holder of an impartible estate as the individual owner of all the properties comprised in the estate;

(iii) **Member of a co-operative society**: a member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, of that building or part thereof;

(iv) **Person in possession of a property**: a person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882;

(v) **Person having right in a property for a period not less than 12 years**: with effect from assessment year 1988-89, a person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of any such transaction as is referred to in clause (f) of Section 269UA, of that building or part thereof.
Note that:

(1) If a firm transfers its house property to its partners, before dissolution, merely by book entries, annual value of the property is taxable in the hands of the firm - Inder Narain Har Narain v. C.I.T. (1980) 3 Taxman 365 (Delhi).

(2) Where a Muslim transfers a property of a value of more than Rs. 100 it must be by registered instrument and not orally. This is the position even with respect to a property purporting to have been orally given over by a Muslim husband to his wife in the discharge of his dower debt to her. Accordingly, the income from a property thus given will be included in the total income of the husband only - Syed Sadique Iman v. C.I.T. (1979) 117 ITR 62 (Patna).

(3) In the case of tenant co-partnership co-operative housing societies, the income from each building should be assessed in the hands of the individual members to whom it has been allotted. Conversely, for all purposes (including attachment and recovery of tax, etc.) the individual members should be regarded as the legal owners of the property in question.

(4) Also, for the purposes of Section 22, the custodian should be treated as owner of an evacuee’s property from the date of its vesting in him. And, in respect of all properties of an evacuee vested in him, an assessment should be made upon the custodian, but in respect of properties vested in him, and belonging to different evacuees, separate assessments in respect of each evacuee should be made upon him.

The relevant status as to residence for the purposes of such assessments, is that of the assessee-custodian and that is resident and ordinarily resident. The rates of income-tax applicable in any such assessment are those appropriate to the total income of a “resident individual”.

Other points with regard to ownership

(i) Official assignee or receiver: Where the owner of the property becomes insolvent, the official assignee or receiver under the law of insolvency shall be chargeable in respect of the income from such house property as the owner. However, the receiver appointed by the Court shall not be deemed to be the owner of the insolvent’s property, because the property does not vest in him.

(ii) Ownership in dispute: Where the title to the property is in dispute, the Assessing Officer is empowered to decide the ownership of the property for income-tax purposes. However, where the decision of the Court is contrary to the Assessing Officer’s decision, the decision of the court will prevail and he will re-assess the assessee accordingly.

(iii) Co-owners of the property: Where the property is owned jointly by two or more persons and their respective shares are definite and ascertainable, they shall be assessed individually on their shares in the income from the property (Section 26).

(iv) Owner in the previous year: Since tax is levied only on the income of previous year, annual value of property owned by a person during the previous year, is taxable in the following assessment year, even if the assessee is not the owner of the property during the assessment year.

(v) Status of property in a foreign country: A resident assessee is taxable
under Section 22 in respect of annual value of a property situated in a foreign
country.

But, a resident but not ordinarily resident or non-resident is chargeable under
Section 22 in respect of income of a house property situated abroad, only if
income is received in India during the previous year. In such cases where tax
incidence is attracted, the annual value is computed as if the property is
situated in India.

**CASE LAWS**

For the determination of ownership of house property,
the following case laws are also relevant:

1. **Ramkumar Mills (P) Ltd. v. CIT** (1989) 47 Taxman 125/180 ITR 464 (Kar.).

   Where there is agreement for sale and possession of
immovable properties too is delivered to vendee but
registered sale deed is not executed, vendee cannot be
treated as owner of the property.

   For purposes of Section 22, ownership of property is transferred only by
execution and registration of sale deed and not by other acts such as delivering
vacant possession and giving all rights or interest in the property including right of
realisation of rent.

Har.).

   Where, in order to discharge debts owed to its directors, assessee company,
recorded in its accounts that with effect from 1.2.1978 its building would belong to
directors and finally registered deed was executed on 2.1.1980, rental income from
building after 1.2.1978 could not be assessed in company’s hands.

P.T. Mannel (1989) 47 Taxman 108 (Ker.).

   Annual letting value of a building belonging to the assessee and which is in the
occupation of a firm in which the assessee is partner, is not includible in income of
the assessee under Section 22.

(d) **Utilised by the assessee for business or profession purpose:**

   The annual value of such property or the portion thereof as is utilised by the
assessee for the purposes of his own business, profession or vocation, the profits of
which are assessable to tax, is not taxable under Section 22. The assessee is also
not allowed to claim any deduction in respect of notional rent while computing income
from any such business, profession or vocation. However, the assessee can claim
depreciation under Section 32 of the Income-tax Act.

(e) **Taxability of rental income from a owned house property**

   Rents or income arising from ownership of any house property cannot be taxed
under any other head since Section 22 provides a specific head for charge of such income to tax. In the case of Commercial Properties Ltd. v. C.I.T. 3 ITC 23, the assessee company had the sole object of acquiring lands, building houses and letting the premises to tenants. It was held that the income from property was taxable under Section 22 and not under Section 28, i.e., profits and gains of business or profession. However, where the subject which is let is not a mere tenement, but is a complex one, e.g., a well-equipped theatre, safe deposits vaults, or vaults for storing or preserving films, including special devices, facilities and services or a well-furnished paying guest establishment - the income cannot be said to be derived from mere ownership of house property but may be assessable as income from business [C.I.T. v. National Storage (P) Ltd. (1967) 66 ITR 596 (SC)].

Similarly, the following income from buildings is not assessable under this head:

(a) **Buildings or staff quarters let out to employees and others.** Where the assessee lets out the building or staff quarters to the employees of business whose residence there is necessary for the efficient conduct of business, the rent collected from such employees is assessable as income from business and taxable under the head business or profession and not under this head. [CIT v. Delhi Cloth & General Mills Co. Ltd. (1966) 59 ITR p.152 (Punjab)].

(b) **If building is let out to authorities for locating bank, post office, police station, central excise office, etc.,** income will be assessable as income from business provided the dominant purpose of letting out the building is to enable the assessee to carry on his business more efficiently and smoothly. [CIT v. National Newsprint and Paper Mills Ltd. (1978) 114 ITR 388 (MP)].

(c) **Composite letting of building with other assets.** Where the assessee lets on hire machinery, plant or furniture belonging to him and also buildings and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting is chargeable to tax under the head "Income from other Sources" if it is not chargeable to income-tax under the head "Profits and gains of business or profession" [Section56(2)(iii)].

(d) **Income of State Industrial Development Corporation for letting out of sheds, etc.** is business income and is not taxable under Section 22 - CIT v. A.P. Small Scale Industrial Development Corpn. (1989) 175 ITR 352 (AP).

(e) **Services rendered in providing electricity, use of lifts, supply of water, maintenance of stair case and watch and ward facilities** are not incidental to letting out property, and charges qua said services are assessable as income from other sources, and not under Section 22 (as income from house property) - CIT v. Model Mfg. Co. (P) Ltd. (1989) 175 ITR 374 (Cal.).

5.11 **Determination of Annual Value u/s 23:**

The measure of charging income-tax under this head is the annual value of the property, i.e., the inherent capacity of a building to yield income. The expression "annual value" has been defined in Section 23(1) of the Income-tax Act as:

(1) For the purposes of Section 22, the **annual value** of any property shall be deemed to be:

(a) the sum for which the property might reasonably be expected to let from year to year; or
(b) where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or
(c) where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable.

Provided that the taxes levied by any local authority in respect of the property shall be deducted (irrespective of the previous year in which the liability to pay such taxes was incurred by the owner according to the method of accounting regularly employed by him) in determining the annual value of the property of that previous year in which such taxes are actually paid by him, i.e., municipal taxes will be allowed only in the year in which it was paid.

Explanation: For the purposes of clause (b) or clause (c) of this sub-section, the amount of actual rent received or receivable by the owner shall not include, subject to such rules as may be made in this behalf, the amount of rent which the owner cannot realise.

(2) Where the property consists of a house or part of a house which:
   (a) is in the occupation of the owner for the purposes of his own residence; or
   (b) cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him,
   the annual value of such house or part of the house shall be taken to be nil.

(3) The provisions of Sub-section (2) shall not apply if:
   (a) the house or part of the house is actually let during the whole or any part of the previous year; or
   (b) any other benefit therefrom is derived by the owner.

(4) Where the property referred to in Sub-section (2) consists of more than one house:
   (a) the provisions of that sub-section shall apply only in respect of one of such houses, which the assessee may, at his option, specify in this behalf;
   (b) the annual value of the house or houses, other than the house in respect of which the assessee has exercised an option under clause (a), shall be determined under Sub-section (1) as if such house or houses had been let.

Rules made on this behalf - Notification No. 198/2001 dated 2-7-2001

The amount of rent which the owner cannot realise shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrevocable only if following conditions are satisfied:

(a) tenancy is bonafide;
(b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
(c) the defaulting tenant is not in occupation of any other property of the assessee;
(d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfied the Assessing Officer that legal proceedings would be useless.

5.12 Computation of Net Annual Value

Net annual value shall be computed in the following manner:
1. Determine the Gross Annual Value
2. Deduct municipal tax actually paid by the owner during the previous year from the Gross Annual Value.

For the purpose of computation of net annual value, properties can be classified into three categories:
(A) Properties let out.
(B) Properties occupied by the owner.
(C) Partly let out and partly self occupied property.

A. Properties let-out [Section 23(1)]

Gross annual value shall be higher of
(a) Expected Rent
(b) Actual rent received or receivable.

The higher of Municipal value and fair rental value shall be Expected rent. However, expected rent shall not exceed the Standard rent.

**Municipal Value:** Municipal value is the value determined by the municipal
authorities for levying municipal taxes on house property.

**Fair rent:** Fair rent is the amount which a similar property can fetch in the same or similar locality, if it is let for a year.

**Standard Rent:** The standard rent is fixed under Rent Control Act. In such a case, the property can not be let for a amount which is higher than the standard rent fixed under the Rent Control Act.

While computing the net annual value the following deduction are made from the gross annual value:

**Taxes:** The taxes including service taxes (fire tax, conservancy tax, education, water tax, etc.) levied by any municipality or local authority in respect of any house property to the extent to which such taxes are borne and paid by the owner, and include enhanced municipal tax finally determined on appeal and payable by assessee - Clive Buildings Cola Ltd. v. CIT (1989) 44 Taxman 160.

However, deduction in respect of municipal taxes will be allowed in determining the annual value of the property only in the year in which municipal taxes are actually paid by the owner.

Where the tax on property is enchanced 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.).]

While calculating the annual value in accordance with Section 23(1) the following situations may arise:

(i) If the property is let out throughout the previous year (No unrealised rent and no vacancy).

(ii) If the property is let out throughout the previous year, but the entire rent could not be collected.

(iii) If the entire rent is collected but the property remains vacant.

(iv) If the property remains vacant and the entire rent is not collected.

**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:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>I</th>
<th>II</th>
<th>III</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal Value</td>
<td>30,000</td>
<td>20,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Actual (De facto) Rent</td>
<td>32,000</td>
<td>28,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Fair Rent</td>
<td>36,000</td>
<td>24,000</td>
<td>32,000</td>
</tr>
</tbody>
</table>
Solution:

In each of the above cases, the gross annual value will be the highest of Municipal Value or Actual or fair Rent. Thus, for House I the gross annual value will be the fair rent of ₹ 36,000. For House II the gross annual value will be the Actual (De facto) Rent of ₹ 28,000, and for House III the gross annual value will be the Municipal Value of ₹ 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:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal Value</td>
<td>₹30,000</td>
<td>₹26,000</td>
<td>₹35,000</td>
<td>₹30,000</td>
</tr>
<tr>
<td>Actual (De Facto) Rent</td>
<td>₹40,000</td>
<td>₹30,000</td>
<td>₹32,000</td>
<td>₹32,000</td>
</tr>
<tr>
<td>Fair Rent</td>
<td>₹36,000</td>
<td>₹28,000</td>
<td>₹30,000</td>
<td>₹36,000</td>
</tr>
<tr>
<td>Standard Rent</td>
<td>₹30,000</td>
<td>₹35,000</td>
<td>₹36,000</td>
<td>₹40,000</td>
</tr>
</tbody>
</table>

Solution

As all the houses are covered by the Rent Control Act, their gross annual value will be:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>G.A.V.</td>
<td>₹40,000</td>
<td>₹30,000</td>
<td>₹35,000</td>
<td>₹36,000</td>
</tr>
</tbody>
</table>

I House: De facto rent is more than the standard rent, hence De facto rent will be gross annual value.

II House: The gross annual value can be less than the standard rent. Hence, actual rent (highest of the three) will be the gross annual value.

III House: The gross annual value can be less than the standard rent. Hence, the municipal value (highest of the three) will be the gross annual value.

IV House: The gross annual value can be less than the standard rent. Hence, the fair rent (highest of the three) will be the gross annual value.

— Annual letting value of self occupied property, subject to Rent Control Act is to be fixed on basis of standard rent and not on basis of open market. Tilak Raj v. CIT (1989) 45 Taxman 279/178 ITR 327 (Punj. & Har.).

— In determining annual value salary paid to caretaker cannot be taken into account CIT v. Smt. Sreelekha Banerjee (1989) 45 Taxman 358/179 ITR 46 (Cal.).

— Loss relating to self occupied house property could be set off against income from other sources CIT v. K.K. Dhanda (HUF) (1989) 45 Taxman 346/178 ITR 602 (Punj. & Har.).
Illustration [Situation (i)]
(i.e. no vacancy no unrealized rent)

X owns a house property. Municipal value ₹ 1,50,000, Fair Rent ₹ 1,25,000, Standard Rent ₹ 1,45,000. It is let out throughout the previous year for ₹ 10,000 p.m. up to December 31, 2010 and ₹ 14,500 p.m. thereafter. Find out the gross assessment year 2011-12.

Solution

\[
\begin{array}{|c|}
\hline
\text{Municipal Value} & ₹ 1,50,000 \\
\text{Fair Rent (b)} & ₹ 1,25,000 \\
\text{Standard Rent (c)} & ₹ 1,45,000 \\
\text{Actual Rent (10,000 x 9 + 14,500 x 3) (d)} & ₹ 1,33,500 \\
\hline
\end{array}
\]

**Step 1:** (a) or (b) whichever is higher, subject to (c) ₹ 1,45,000

**Step 2:** If (d) is higher than the amount determined under step 1, then (d) will be taken as gross annual value [since (d) is less than ₹ 1,45,000, step (2) is not applicable]

**Step 3:** Not applicable as house did not remain vacant.

Illustration [Situation (ii)]
(i.e. No vacancy but there is unrealized rent)

Mr. A owns two houses. The expected rent of the house one is ₹ 65,000. This house was let out for ₹ 7,500 p.m. But the rent for the months of Feb. and March 2011 could not be realized.

The expected rent of another house is ₹ 1,50,000. This house was let out for ₹12,000 p.m. But the rent for the last three months could not be realized.

In the both cases, Mr. A fulfills the conditions of Rule 4. You are required to compute the Gross Annual Value of both the houses.

Solution

<table>
<thead>
<tr>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>House I</strong></td>
<td><strong>House II</strong></td>
</tr>
<tr>
<td>Expected Rent</td>
<td>65,000</td>
</tr>
<tr>
<td>Annual Rent</td>
<td>90,000</td>
</tr>
<tr>
<td>Unrealized Rent</td>
<td>15,000</td>
</tr>
</tbody>
</table>

**Computation of Gross Annual Value**

**Step 1:** Expected Rent

<table>
<thead>
<tr>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>House I</strong></td>
<td><strong>House II</strong></td>
</tr>
<tr>
<td>65,000</td>
<td>1,50,000</td>
</tr>
</tbody>
</table>
**Step 2:** Actual Rent (After deducting unrealized rent)
if higher than Expected Rent then Actual rent
otherwise Expected rent
**Step 3:** Applicable only in case of vacancy
Gross Annual Value

**Illustration [Situation (iii)]**
(There is vacancy but no unrealized rent)

Find out the gross annual value in the case of the following properties for the Assessment year 2011-12

<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>Q</th>
<th>R</th>
<th>S</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected Rent</td>
<td>70</td>
<td>55</td>
<td>85</td>
<td>125</td>
</tr>
<tr>
<td>Rent Per Month (if let out)</td>
<td>7</td>
<td>5</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Let out period (in months)</td>
<td>11</td>
<td>0</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td>Vacancy (in months)</td>
<td>1</td>
<td>12</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

Further all the rent were realized for the year by the assessee.

**Solution:**

Calculation of Gross Annual Value of Mr. X for A.Y 2011-12

<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>Q</th>
<th>R</th>
<th>S</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Rent (If let out for 12 months)</td>
<td>84</td>
<td>60</td>
<td>96</td>
<td>96</td>
</tr>
<tr>
<td>Loss due to vacancy</td>
<td>7</td>
<td>60</td>
<td>24</td>
<td>16</td>
</tr>
<tr>
<td>Unrealized rent</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Actual Rent (for let out period)</td>
<td>77</td>
<td>Nil</td>
<td>72</td>
<td>88</td>
</tr>
<tr>
<td>Decline due to vacancy in Expected Rent (i.e. Expected Rent minus Loss due to vacancy but not less than actual rent received)</td>
<td>63</td>
<td>0</td>
<td>72</td>
<td>109</td>
</tr>
</tbody>
</table>

Calculation of Gross Annual Value

**Step 1:** Expected Rent

<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>Q</th>
<th>R</th>
<th>S</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected Rent</td>
<td>70</td>
<td>55</td>
<td>85</td>
<td>125</td>
</tr>
</tbody>
</table>

**Step 2:** If actual rent is more than Expected Rent than Actual rent otherwise expected Rent

<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>Q</th>
<th>R</th>
<th>S</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual Rent</td>
<td>77</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

**Step 3:** If property remain vacant then decline due to vacancy shall be considered

<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>Q</th>
<th>R</th>
<th>S</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross annual value</td>
<td>70</td>
<td>0</td>
<td>72</td>
<td>109</td>
</tr>
</tbody>
</table>
Illustration [Situation (iv)]
(Vacancy and unrealized rent both exist)

Mr. X is the owner of a house property. He lets this property during the previous year 2009-10 for ₹ 7,000 p.m. The house was occupied from 1.4.2010 to 31.1.2011. From 1.2.2011 it remained vacant. Mr. X fails to realize ₹ 10,000 from the tenant. The Expected rent of the house is ₹ 82,000 p.a.

Calculate the Gross Annual Value of the house.

Solution

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected Rent</td>
<td>₹ 82,000</td>
</tr>
<tr>
<td>Annual Rent (Actual for the whole year – 7000 x 12)</td>
<td>₹ 84,000</td>
</tr>
<tr>
<td>Actual Rent (7,000 x 10)</td>
<td>₹ 70,000</td>
</tr>
<tr>
<td>Unrealized rent</td>
<td>₹ 10,000</td>
</tr>
<tr>
<td>Realized rent (₹ 70,000 – 10,000)</td>
<td>₹ 60,000</td>
</tr>
<tr>
<td>Loss Due to vacancy (84,000 – 70,000 for 2 months)</td>
<td>₹ 14,000</td>
</tr>
<tr>
<td>Decline due to vacancy (₹ 82,000 – 14,000) but not less than actual rent received</td>
<td>₹ 68,000</td>
</tr>
</tbody>
</table>

Calculation of Gross Annual Value

Step 1: Expected Rent 82,000

Step 2: If actual rent is more than expected rent than actual rent otherwise expected rent N.A.

Step 3: Decline due to vacancy in Expected Rent (i.e. Expected Rent minus Loss due to vacancy but not less than actual rent received) 68,000

Gross Annual Value 68,000

B. Property occupied by the owner [Section 23(2)]

Where the property consists of one house or part of a house in the occupation of the owner for his own residence, and is not actually let during any part of the previous year and no other benefit is derived therefrom by the owner, the annual value of such a house or part of the house shall be taken to be nil. The only deduction available in respect of such house is towards interest on borrowed capital in terms of Section 24(1)(vi) but subject to a ceiling of ₹ 30,000 or ₹1,50,000 as the case may be. In other words, to this extent there could be a loss from such house.

Concession for one House only:

Where the assessee has occupied more than one house for the purposes of residence for himself and family members, he has to make a choice of one house only in respect of which he would like to claim exemption. Other self-occupied houses will be treated as if they were let out and their annual value will be determined in the same manner as we have discussed in the case of let out property.
The concessions in respect of self occupied residential house are available to an individual or H.U.F. assessee. Firms, companies, etc. are not considered to have used a house for their residential purposes. A partnership firm using its own building for the residence of its partners cannot claim the concessions in respect of self occupied residential house mentioned above. C.I.T. v. Dewan Chand Dholan Das (1981) 132 ITR 790. Similarly, these concessions are not available in a case where the assessee lets out his house to his employer and employer allots the same to the assessee for his residential purposes. In such a case, the assessee occupies the house not as an owner but as a sub tenant of his employer D.R. Sunder Raj v. C.I.T. (1979) 2 Taxman 458 (A.P.).

In respect of such house, no deduction whatsoever is allowed except interest upto ₹ 30,000 or ₹1,50,000 as the case may be on the borrowed capital. In other words, a loss to the maximum extent of ₹ 30,000 or ₹1,50,000 can be reported in respect of such houses. If any property is purchased or constructed out of funds borrowed on or after 1st April, 1999, the restriction on the amount of interest deductible in respect of such self-occupied houses shall be relaxed so as to secure a deduction upto ₹ 1,50,000 provided the purchase/construction is completed within three years from the end of the financial year in which capital was borrowed.

C. House which is Partly Self-occupied and Partly Let Out:

In such a case, the procedure for computation of annual value is as follows:

(a) Property let out partially:

When a portion of the house is self-occupied for the full year and a portion is self-occupied for whole year, the annual value of the house shall be determined as under:

(i) From the full annual value of the house the proportionate annual value for self-occupied portion for the whole year shall be deducted.

(ii) The balance under (i) shall be the annual value for let out portion for a part of the year.

Illustration

Mr. R. owns a house. The Municipal value of the house is ₹ 50,000. He paid ₹8,000 as local taxes during the year. He uses this house for his residential purposes but lets out half of the house @ ₹ 3,000 p.m. Compute the annual value of the house.

Solution

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual rent or Municipal valuation (higher)</td>
</tr>
<tr>
<td>Less : Local taxes paid</td>
</tr>
<tr>
<td>Annual value of House Property</td>
</tr>
<tr>
<td>Less : Half of annual value regarding self occupied portion for the whole year</td>
</tr>
<tr>
<td>Annual Value of let out portion</td>
</tr>
</tbody>
</table>
(b) House let out during any part of the previous year and self occupied for the remaining part of the year:

In this case the benefit of Section 23(2) is not available and the income will be computed as if the property is let out.

Illustration

M is the owner of a house. The municipal value of the house is ₹ 40,000. He paid ₹ 8,000 as local taxes during the year. He was using this house for his residential purposes but let out w.e.f. 1.1.2011 @ ₹ 4,000 p.m. Compute the annual value of the house.

Solution

\[
\begin{align*}
\text{Annual rent or municipal valuation (whichever is higher)} & \quad 48,000 \\
\text{Less : Local taxes} & \quad 8,000 \\
\text{Annual value of the house} & \quad 40,000 \\
\end{align*}
\]

(No benefit shall be given for self occupied period as the house did not remain vacant during the previous year)

(c) Self-occupied House remaining vacant:

If the assessee has reserved only one of the houses (owned by him) for his residence or he is the owner of only one house which is meant for his own residence but could not be occupied by him for residential purposes in the previous year owing to the fact that he had to live at some other place in a house not belonging to him, then he can claim non-occupation or vacancy allowance during the previous year for the period during which house remained vacant. The reason for his living at a different place might be for business or professional purposes or for a salaried employee due to transfer etc. The annual value of the house, which remained vacant in these circumstances, shall be nil.

The above mentioned concession will be granted to the assessee only if he has neither let out the said house nor has derived any benefit from it during the period for which it remained vacant. No deduction, except interest on borrowed capital up to a maximum of ₹ 30,000 is allowed in computing income from such a house. This amount of ₹ 30,000 has been increased by Finance Act, 2001 w.e.f. AY 2002-03 to ₹ 1,50,000 where property is acquired or constructed with capital borrowed on or after the 1st day of April 1999 and such acquisition or construction is completed within three years from the end of the financial year in which capital was borrowed.

D. Property owned by co-owners (Section 26):

Where the property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons and their respective shares are definite and ascertainable, the share of each such person shall be included in his total income and they shall not be assessed as an association of persons and share of each co-owner shall be computed as if each such person is individually entitled to the relief provided in Section 23(2).
5.13 Deductions from Income from House Property (Section 24)

W.e.f. Assessment Year 2002-03, income chargeable under the head “Income from house property” shall be computed after making the following deductions, namely:

(a) **Standard deduction:** a sum equal to 30% of the annual value;
(b) **Interest on borrowed capital:** where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital:

Provided that in respect of property referred to in sub-section (2) of section 23, the amount of deduction shall not exceed ₹30,000:

Provided further that where the property referred to in the first proviso to acquired or constructed with capital borrowed on or after the 1st day of April, 1999 and such acquisition or construction is completed within three years from the end of the financial year in which capital was borrowed, the amount of deduction under this clause shall not exceed ₹1,50,000.

*Explanation.*—Where the property has been acquired or constructed with borrowed capital, the interest, if any, payable on such capital borrowed for the period prior to the previous year in which the property has been acquired or constructed, as reduced by any part thereof allowed as deduction under any other provision of this Act, shall be deducted under this clause in equal instalments for the said previous year and for each of the four immediately succeeding previous years (means in 5 equal instalments):

Provided also that no deduction shall be made under the second proviso unless the assessee furnishes a certificate, from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property, or, conversion of the whole or any part of the capital borrowed which remains to be repaid as a new loan.

*Explanation.*—For the purposes of this proviso, the expression “new loan” means the whole or any part of a loan taken by the assessee subsequent to the capital borrowed, for the purpose of repayment of such capital.
Amounts not deductible from income from house property

Notwithstanding anything contained in section 24, any interest chargeable under this Act which is payable outside India (not being interest on a loan issued for public subscription before the 1st day of April, 1938), on which tax has not been paid or deducted under Chapter XVII-B of the Act and in respect of which there is no person in India who may be treated as an agent under section 163 shall not be deducted in computing the income chargeable under the head “Income from house property”.

Special provision for cases where unrealised rent allowed as deduction is realised subsequently (Section 25A)

This section provides that where deduction has been allowed under Section 24(1)(x) (as it stood immediately before its substitution by the Finance Act, 2001) in respect of unrealised rent and subsequently during any previous year the assessee has realised any amount in respect of such rent, the amount so realised will be deemed as income under the head “Income from house property” and accordingly charged to tax (without making any deduction under Section 23 or 24, as it stood immediately before its substitution by the Finance Act, 2001) as the income of that previous year, irrespective of whether the assessee is the owner of that property in that year or not.

The above list of allowable expenses is exhaustive and no other expenses, such as, commission on arranging loans for house property or succession duty in respect of house property or expenses of tenancy agreement shall be allowed as deductions.

W.e.f. Assessment Year 2002-03, no deduction under Section 24(1) is allowable in respect of unrealised rent as under the amended provision of determination of annual value, it will be already adjusted while computing the annual value. Consequently Section 25A will be applicable only for the recovery of that unrealised rent which has been allowed as deduction upto Assessment Year 2001-02.

Unrealised rent received subsequently to be charged to income-tax (Section 25AA)

A new Section 25AA has been inserted as under to tax the recovery of unrealised rent, as such unrealised rent must have been considered while determining the annual value for assessment year 2002-03 and onwards.

Where the assessee cannot realise rent from a property let to a tenant and subsequently the assessee has realised any amount in respect of such rent, the amount so realised shall be deemed to be income chargeable under the head “Income from house property” and accordingly charged to income-tax as the income of that previous year in which such rent is realised whether or not the assessee is the owner of that property in the previous year.

Taxation of arrears of rent in the year of receipt (Section 25B)

Section 25B inserted in the Income-tax Act w.e.f. assessment year 2001-2002 provides that if any arrears of rent, other than what has already been taxed under Section 23, are received in a subsequent year, the same will be taxed in the year of receipt whether the property is owned by the assessee in the year of receipt or not. A
deduction of sum equal to one-fourth of such amount of rent shall be allowed towards repairs and collection of rent.

**Amounts not deductible from income from house property (Section 25)**

Where the amount of interest on money borrowed for the purpose of house property is payable outside India and it is chargeable under the Act, it shall not be allowed as a deduction unless:

(i) tax has been paid or deducted at source in respect of such payment, or
(ii) there is a person in India who may be treated as an agent or representative of the non-resident to whom such payments have been made.

5.14 Loss from House Property

When the aggregate amount of permissible deduction exceeds the net annual value of the property, there will be a loss from that property. This loss can be set-off against the income from any other house property. If even after the set-off, there is an unabsorbed balance of the loss, the same can be set-off against income under any other head in the same year and the balance unabsorbed part of the loss can be carried forward in terms of Section 71B for set off within the subsequent eight assessment years against income from house property. However, where the self-occupied property consists of one residential house only and it could not be occupied by the owner for the reasons that owing to his employment, business or profession carried on at any other place, he had to reside at that other place in a building not belonging to him (rented or otherwise), the loss can neither be set-off against the income from any other house nor can it be set-off against the income under any other head.

**Illustrations**

<table>
<thead>
<tr>
<th>Chart Showing Computation of Taxable Income from House Property</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross Annual Value of the house</strong> XXX</td>
</tr>
<tr>
<td><strong>Less: Local Taxes paid by the owner during the previous year</strong> XXX</td>
</tr>
<tr>
<td><strong>Annual Value</strong> XXX</td>
</tr>
<tr>
<td><strong>Less: Deduction under Section 24: For house let out or deemed to be let out:</strong></td>
</tr>
<tr>
<td>(i) <strong>Repairs and Collection Charges</strong> (30% of Annual Value) XXX</td>
</tr>
<tr>
<td>(ii) (a) <strong>Interest on loan, taken for purchase, construction of repair of the house, relating to previous year</strong> XXX</td>
</tr>
<tr>
<td>(b) <strong>Interest on loan for the period prior to the previous year in which the house is completed is also allowable in five equal annual instalments</strong> XXX XXX</td>
</tr>
<tr>
<td><strong>Taxable Income from House Property</strong> XXX</td>
</tr>
</tbody>
</table>
**Illustration:**

Mr. X is the owner of four houses. The following particulars are available:

<table>
<thead>
<tr>
<th>House</th>
<th>House 1</th>
<th>House 2</th>
<th>House 3</th>
<th>House 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal valuation</td>
<td>16,000</td>
<td>20,000</td>
<td>24,000</td>
<td>5,600</td>
</tr>
<tr>
<td>Rent (Actual)</td>
<td>14,000</td>
<td>20,000</td>
<td>6,800</td>
<td></td>
</tr>
<tr>
<td>Municipal taxes</td>
<td>400</td>
<td>1,000</td>
<td>1,200</td>
<td>300</td>
</tr>
<tr>
<td>Repairs and collection charges</td>
<td>200</td>
<td>2,500</td>
<td>1,040</td>
<td>460</td>
</tr>
<tr>
<td>Interest on mortgage</td>
<td>—</td>
<td>100</td>
<td>—</td>
<td>1,000</td>
</tr>
<tr>
<td>Ground rent</td>
<td>—</td>
<td>—</td>
<td>100</td>
<td>—</td>
</tr>
<tr>
<td>Fire premium</td>
<td>140</td>
<td>—</td>
<td>200</td>
<td>—</td>
</tr>
<tr>
<td>Annual charges</td>
<td>—</td>
<td>—</td>
<td>360</td>
<td>—</td>
</tr>
</tbody>
</table>

House No. 1 is self-occupied.

House No. 2 is let out for business, construction was completed on 1.3.90 and consists of two residential units.

House No. 3 is 3/4 used for own business 1/4 let out to the manager of the business.

House No. 4 is let out for residential purposes.

His other income is ₹ 30,000. Find out the income of X from house property for the assessment year 2012-13.

**Solution:**

**House No. 1**

<table>
<thead>
<tr>
<th>₹</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal valuation</td>
<td>16,000</td>
</tr>
<tr>
<td>Annual value deemed to be</td>
<td>NIL</td>
</tr>
</tbody>
</table>

**House No. 2**

<table>
<thead>
<tr>
<th>₹</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair rental value</td>
<td>20,000</td>
</tr>
<tr>
<td>Less: Municipal taxes</td>
<td>1,000</td>
</tr>
<tr>
<td>Net annual value</td>
<td>19,000</td>
</tr>
<tr>
<td>Less: 30% of Net Annual Value</td>
<td>5,700</td>
</tr>
<tr>
<td></td>
<td>13,300</td>
</tr>
</tbody>
</table>

**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**

<table>
<thead>
<tr>
<th>₹</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent Received</td>
<td>6,800</td>
</tr>
</tbody>
</table>
Less: Municipal taxes 300
Net annual Value 6,500
Less: 30% of Net Annual Value 1,950
4,550

Income from House Property: ₹ NIL + ₹ 13,300 + ₹ 4,550 = ₹ 17,850. It is presumed that House No. 4 has not been mortgaged for purposes of acquiring or repairs on the house property.

Illustration

Mr. and Mrs. O.P. Gupta are co-owners of a property having equal shares. The construction of the property was begun in July 1991 and completed in September 1996. They furnished the following particulars for the assessment year 2012-13 in respect of the property.

One-third of the property is occupied by the co-owners and the remaining two-thirds is let for residential purposes. The let out portion which constitutes two units fetches rent of ₹ 27,000 per annum. The letting value of the property as per municipal records is ₹ 36,000. Municipal taxes of ₹ 4,050 have been paid by the co-owners. Besides, they paid ₹ 1,350 as ground rent and ₹ 900 as insurance premium. The co-owners also paid ₹ 9,000 as interest on loan taken for the construction of the house.

Compute the income from the house property from the assessment year 2012-13 if other incomes of Mr. and Mrs. O.P. Gupta are ₹ 60,000 and ₹ 22,500 respectively during the same period.

Solution

Computation of income from house property for the assessment year 2012-13

**LET OUT PORTION**

Gross annual value: To be higher of the following:

(a) Notional income based on municipal valuation
   \[ \frac{2}{3} \times \text{₹ 36,000} = \text{₹ 24,000} \]
(b) Annual rent = ₹ 27,000

\[ \begin{align*}
   \text{Gross Annual Value} & = 27,000 \\
   \text{Less: Full municipal taxes paid by the co-owners} & = 2,700 (2,700) \\
   \text{Net Annual Value} & = 24,300 \\
   \text{Less: Deduction from net annual value:} & \\
   \text{(i) 30% of Net Annual Value} & = 7,290 \\
   \text{(ii) Interest on loan taken for the construction} & \\
   \text{of the house} & = \frac{2}{3} \times \text{₹ 9,000} = \text{₹ 6,000} (6,000) \\
   \text{Taxable income} & = 13,290 \\
   \text{Share of Mr. Gupta} & = \text{₹ 5,505} \\
   \text{Share of Mrs. Gupta} & = \text{₹ 5,505}
\end{align*} \]
SELF-OCCUPIED PORTION

Gross annual value: to be higher of the following:

(i) Municipal valuation:
\[
\frac{1}{3} \times ₹36,000 = ₹12,000 \text{ or }
\]

(ii) Fair rent (₹27,000 x 3/2 x 1/3) ₹13,500

Gross Annual Value 13,500
Annual Value 13,500

<table>
<thead>
<tr>
<th>Share of</th>
<th>Share of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Gupta</td>
<td>Mrs. Gupta</td>
</tr>
<tr>
<td>₹</td>
<td>₹</td>
</tr>
<tr>
<td>6,750</td>
<td>6,750</td>
</tr>
</tbody>
</table>

Apportionment of Annual value
among the co-owners 1:1 6,750 6,750

Annual value of self-occupied property for each
co-owner is taken to be [Section 23(2)(a)(i)
read with explanation to Section 26] Nil Nil

Less: Deduction from net annual value:
Interest on loan 1,500 1,500
Loss: ( - )1,500 ( - )1,500

Statement of total income from house property:

Let out portion 5,505 5,505
Self-occupied portion ( - )1,500 ( - )1,500
4,005 4,005

Illustration

Mr. Lal is the owner of a house property. Its municipal valuation is ₹80,000. It has been let out for ₹1,20,000 p.a. The local taxes payable by the owner amount to ₹16,000 but as per agreement between the tenant and the landlord, the tenant has paid the amount direct to the municipality. The landlord, however, bears the following expenses on tenant's amenities:

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extension of water connection 3,000</td>
</tr>
<tr>
<td>Water charges 1,500</td>
</tr>
<tr>
<td>Lift maintenance 1,500</td>
</tr>
<tr>
<td>Salary of gardener 1,800</td>
</tr>
<tr>
<td>Lighting of stairs 1,200</td>
</tr>
<tr>
<td>Maintenance of swimming pool 750</td>
</tr>
</tbody>
</table>

The landlord claims the following deductions:

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repairs and Collection charges 7,500</td>
</tr>
<tr>
<td>Land revenue paid 1,500</td>
</tr>
</tbody>
</table>
Compute the taxable income from the house property for the assessment year 2012-13.

Solution

**Computation of income from house property for the assessment year 2012-13.**

Gross annual value: to be higher of the following:

- (a) Municipal valuation ₹ 80,000
- or
- (b) *De facto* rent (₹ 1,20,000 less value of amenities)

Rent Received: 1,20,000

*Less: Value of the amenities provided by the assessee:*

(i) Extension of water connection not deductible as it is capital expenditure
(ii) Water charges 1,500
(iii) Lift maintenance 1,500
(iv) Salary of gardener 1,800
(v) Lighting of stairs 1,200
(vi) Maintenance of swimming pool 750  (6,750)

Gross annual value 1,13,250

*Less: Local tax ₹ 16,000:*

No deduction is permissible as the taxes have been paid by the tenant

Net annual value 1,13,250

*Less: Standard deduction from net annual value:*

30% of Net Annual Value 33,975
Taxable Income 79,275

Illustration

X owned two house properties - the first of which was used half for running his business and the other half was let out at ₹ 3,000 per month. The second property was wholly used as a residence by X. Municipal taxes for the two properties were the same at ₹ 7,200 each per annum. The business and the let out premises were insured against loss by fire and the insurance premium was ₹ 900. Compute X's income from house property.

Solution

**Computation of income under the head „Income from house Property‟**

₹

FIRST PROPERTY (LET OUT PORTION)

Gross annual value (3,000 × 12) 36,000
Less: Municipal taxes  (3,600)
Net annual value  32,400
Less: Deduction under Section 24 (30% of Net Annual Value)  9,720
22,680
Income from first property - Let out portion  22,680
Income from first property - used for business  NIL
Income from second property - self occupied  NIL
Income under the head 'Income from house property'  22,680

Notes:
1. Income from one self occupied property is to be taken as nil.
2. Income from property used for the assessee's own business is to be taken as nil.

Illustration
For the assessment year 2012-13 Sonu submits the following information:

Income from business (speculative)  ₹ 40,000

<table>
<thead>
<tr>
<th>Property Income</th>
<th>House I</th>
<th>House II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal valuation</td>
<td>₹ 35,000</td>
<td>₹ 80,000</td>
</tr>
<tr>
<td>Rent received</td>
<td>₹ 38,000</td>
<td>₹ 68,000</td>
</tr>
<tr>
<td>Municipal taxes paid by tenant</td>
<td>₹ 3,000</td>
<td>₹ 4,000</td>
</tr>
<tr>
<td>Repairs paid by tenant</td>
<td>₹ 500</td>
<td>₹ 18,000</td>
</tr>
<tr>
<td>Land revenue paid</td>
<td>₹ 2,000</td>
<td>₹ 16,000</td>
</tr>
<tr>
<td>Insurance premium paid</td>
<td>₹ 500</td>
<td>₹ 2,000</td>
</tr>
<tr>
<td>Interest on borrowed capital for payment of municipal tax of house property</td>
<td>₹ 200</td>
<td>₹ 400</td>
</tr>
</tbody>
</table>

Nature of occupation
- Let out for residence
- Let out for business

Date of completion of construction
- 1.4.1994
- 1.7.1992

Determine the taxable income of Sonu for the assessment year 2012-13.

Solution:

Computation of Taxable Income of Sonu for Assessment Year 2012-13

House I
Gross Annual Value  38,000
Less: Municipal Taxes - not deductible since paid by tenant  NIL
Net Annual Value  38,000
Less: 30% of Net Annual Value  11,400
Taxable Income  26,600

House II
Gross Annual Value  80,000
Less: Taxes - not deductible, paid by tenant  NIL
Net Annual Value 80,000
Less: 30% of Net Annual Value 24,000
Taxable Income 56,000

Total Income = ₹26,600 + ₹56,000 + ₹40,000 = ₹1,22,600.

Note: Interest on borrowed capital for payment of municipal tax is not allowed as deduction under Section 24 of the Act.

5.15 Exemptions

(A) Items of income from house property which are exempt from Income-tax are:

(i) Income from house property situated in the immediate vicinity of or on the agricultural land and used as a dwelling house, store-house or other out-house by the cultivator or receiver or rent-in-kind. (For details see Agricultural Income, Study-I). [Section 2(1A) read with Section 10(1)].

(ii) Income from property held under trust for charitable or religious purposes (Section 11).

(iii) Income from property occupied by the owner for the purposes of his business or profession carried on by him and the profits of which are chargeable to Income tax. If the profits of business or profession are not chargeable to tax because the income of that business or profession is exempt from tax, the income from the house property shall be chargeable under this head (Section 22).

(iv) Income from residential house where the house consists of one residential house only and it could not be occupied by the owner on account of his employment, business or profession carried on at any other place and he lives at such place in a house which does not belong to him. The income shall be exempt provided:

(a) The house was not occupied by the owner during the whole of the previous year; or

(b) The house was not let; or

(c) No other benefit was derived by the owner [Section 23(3)].

(v) Income from house property belonging to a Registered Trade Union [Section 10(24)].

(vi) Income of an authority constituted under any law for the time being in force for the marketing of commodities; any income derived from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities [Section 10(29)].

(vii) The annual value of any one palace in the occupation of an ex-ruler [Section 10(19A)].

(viii) Income from house property belonging to a local authority [Section 10(20)].

(ix) Income from property of an authority constituted for the purpose of planning, development, or improvement of cities, towns and villages [Section 10(20A)].

(x) Income from property of the approved scientific research association subject to fulfillment of certain conditions [Section 10(21)].

(xi) Income from property of a games association [Section 10(23)].

(xii) Income from property in the case of a person resident of Ladakh.
(xiii) Income from property of a political party (Section 13A).

(B) Income which are included in gross total income but do not form part of the total income:

(i) Income of a co-operative society from the letting of godowns or ware-houses for storage, processing or facilitating the marketing of commodities [Section 80P(2)(e)].

(ii) Income from house property of a co-operative society, not being a housing society or an urban consumers society or a society carrying on transport business or a society engaged in any manufacturing operations with the aid of power, where the gross total income of the society does not exceed rupees twenty thousand [Section 80P(2)(f)].

PART III: INCOME FROM BUSINESS OR PROFESSION

5.16 „BUSINESS’ OR „PROFESSION’

The most important head of income is the head ‘Profits and gains of Business or Profession’. While the provisions of Sections 28 to 44D deal with the method of computing income under head ‘Profits and Gains of Business or Profession’. But both these definitions are neither exhaustive nor specific and clear.

5.16.1 Meaning of Business

The meaning of the expression ‘Business’ has been defined in Section 2(13) of the Income-tax Act. According to this definition, business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. The concept of business presupposes the carrying on of any activity for profit, the definition of business given in the Act does not make it essential for any taxpayer to carry on his activities constituting business for a considerable length of time. In other words, continuity of the business is not the deciding factor in determining whether an assessee has been carrying on any business or not, for even a single or isolated transaction entered into with the idea of making profit would be a business within the meaning of the definition given in Section 2(13). So long as the activity or enterprise of the assessee can be brought within the meaning of the expression ‘any adventure or concern in the nature of trade, commerce or manufacture’, the assessee would be said to carry on a business and would consequently be chargeable to tax under this head in respect of the profits and gains derived therefrom. The concept of business presupposes the existence of the assessee’s intention to make a profit out of his transactions. The object to make profit must be inherent in the transaction although the ultimate result of the transaction may be such that the assessee had to incur loss. Thus, the assessability of profits and gains from business under this head does not in any way depend upon the ultimate outcome of the venture or transaction yielding income or loss. A loss incurred from business is as much assessable under this head as profit which is chargeable to tax. There may be cases where a tax payer may acquire an asset not with the idea of selling it at a profit but to retain it as his own investment. In such cases the profit or gain derived from the sale or other transfer of such an investment would constitute a capital profit which cannot be charged to tax under the head ‘income from business or profession’. However, if the same assessee who holds some investments, decides at a later point of time to convert this investment into stock-in-trade and deals with
them as part of his business assets in the normal course of his business, the profit or
gain derived from the sale of the same asset in the ordinary course of the business
would constitute income assessable under this head. The fact that the asset
concerned was originally acquired without the idea of making profit on sale, is
immaterial for the purpose of assessment. Where a taxpayer acquires an asset with
the sole object of making of profit by reselling the asset, but does not sell it for quite
some time and later on disposes off the asset at a profit, the profit derived from sale
would still be assessable under this head although the assessee had held the asset
with him for quite some time. Thus, the concept of business presupposes an
operation consisting substantially of production or sale or purchase and sale or
making arrangements for the production, sale etc. of commodities. Thus, an agency
which does not involve actual purchases or sale but acting as intermediary would
also constitute the carrying on of a business. Therefore, the definition of business
given in Section 2(13) is so wide as to cover every case of transaction entered into
with the idea of earning income. In most cases, the concept of business is based
upon the idea of the continuous exercise of activities of a series of a similar nature
which taken together yield income. But the carrying on of a business for a
considerable length of time is not essential for attracting liability to tax under this head
because profit derived even from an isolated venture which is in the nature of trade
would still be taxable under this head even in cases where the adventure in the
nature of trade had come to end or the cost in respect of the venture had been fully
recouped to the assessee. For instance, if a person purchases a piece of land, gets it
surveyed, lays down a scheme of development, divides it into a number of building
plots and sells some of the plots from time to time, he would be chargeable to tax not
only on the notional profits made on individual sale of plots but also on the surplus, if
any, remaining after the sale of all plots and after the venture had come to an end. In
other words, tax is chargeable on the income of the assessee arrived at after
deducting from the sale proceeds the cost of the plots and also the expenses which
are incidental thereto.

5.16.2 Meaning of Profession:

The expression ‘Profession’ has been defined in Section 2(36) of the Act to
include any vocation. In the case of a profession, the definition given in the Act is
very much inadequate since it does not clearly specify what activities constitute
profession and what activities do not. According to the generally accepted principles,
the meaning of the term ‘profession’ involves the concept of an occupation requiring
either intellectual skill or manual skill controlled and directed by the intellectual skill of
the operator. For instance, an auditor carrying on his practice, the lawyer or a doctor,
a painter, an actor, an architect or sculptor, would be persons carrying on a
profession and not a business. The common feature in the case of both profession as
well as business is that the object of carrying them out is to derive income or to make
profit. The process of making the profit would be the main area of difference between
the two while the ultimate object is common to both.

5.16.3 Continuity of Business or Profession:

As has already been mentioned, the existence of continuity in the business or
profession is not an essential condition for making the assessee liable to tax under
this head. Thus, receipts arising from the exercise of a business or profession would
still be chargeable to tax under this head although they may be both casual and non-recurring in nature. Consequently, the exemption available under Section 10(3) for receipt of a casual and non-recurring nature would not be available to income derived from business although carrying on the business would be casual and the receipt of income may be such that it does not recur at all. In determining the taxability of profit under the head business or profession arising from transactions of an isolated nature, the following principle should be taken into account to ascertain whether the transaction is an adventure in the nature of trade:

(i) The transaction is said to be in the nature of trade only if some of the elements of trade are found in the transaction, the most important being the object of making profit. It is not essential that all the activities following the main object of the business and which constitute separate transactions by themselves must be entered into with the idea of making profit. In other words, a person whose object is to carry on a business may indulge in certain transactions knowing fully well that he would have to incur loss although he may derive income from the others (e.g. the case of dealer in shares).

(ii) The purchase of an asset or property with the intention to resell the same may be one of the vital factors in determining the nature of the transaction but the intention to resell at a profit is not to be taken as the only factor for this purpose. This is because of the fact that the cases where the assessee has no intention of enjoying or holding the property, there would be a strong presumption that the transaction is in the nature of trade although this presumption may be rebuttable in certain circumstances depending upon the facts of the case.

(iii) It is, however, not possible to evolve a common test or formula which could be applied uniformly in all cases to determine whether a particular transaction is an adventure in the nature of trade or not. The nature of the transaction will have to be determined in each case depending upon the facts or circumstances. The concept of income based upon the principles discussed under Section 4 laying down the principles to be applied for distinguishing between receipts of a capital and revenue nature must be followed even in cases where income is to be computed under this head. In other words, the taxability of income under this head depends primarily upon the fact that the receipt in question is of a revenue nature and is consequently assessable as income under the Act. However, there are a few cases where capital receipts are also chargeable to tax as income from business as has been explained in the next pages.

Test Your Knowledge

The expression 'Profession' has been defined in Section 2(36) of the Act to include any----------------

(a) Idea
(b) Vocation
(c) Business
(d) Purchase

Correct answer: b
5.17 INCOME CHARGEABLE TO INCOME-TAX (SECTION 28)

The scope of income chargeable under the head ‘Profits and Gains from business or Profession’ is covered by Section 28 of the Act which lays down that the following items of income must be charged to tax under this head:

(i) The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year.

(ii) (a) Any compensation or other payment due to or received by any person (by whatever name called) managing the whole or substantially the whole of the affairs of an Indian Company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto.

(b) Any compensation or other payment due to or received by any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto.

(c) Any compensation or other payment due to or received by any person for or in connection with the vesting in the Government or any corporation owned or controlled by the Government under any law for the time being in force of the management of any property or business;

The three items of compensation for termination of a managing agency or other agency specified above constitute an exception to the rule that capital receipts are not normally treated as income for the purposes of taxation. But the fact that these compensations are taxable as business income does not in any way alter the character of the receipt which is of a capital nature. This is because of the fact that compensation received for termination of an agency is in replacement of the source of income itself and thus constitutes a capital receipt.

(iii) Any income derived by a trade or professional or other similar association from the specific services performed by it for its members.

Trade association means an association of businessmen for the protection and advancement of their common interest e.g. a Chamber of Commerce. Section 28(iii) does not apply to other social associations e.g. a sports club or cricket club etc. Similarly the income of a charitable trust from specific services rendered to its members is not assessable under Section 28(iii) but exempted under Section 11 [C.I.T. v. South Indian Film Chamber of Commerce (1981) 129 I.T.R. p. 22 (Mad.)].

According to the general principles of mutuality and the principle that no one can make a profit out of himself, mutual associations or bodies are exempt from income-tax in respect of the net results of the transactions with their own members. These exemptions generally apply to associations like Chambers of Commerce, Seller's Associations, Buyer's Associations, Stock Broker's Associations, etc. But according to Clause (iii) of Section 28 which constitutes an exception to the principle of mutuality, any income derived by a trade or professional association by rendering specific services to any of its members.
members would constitute income from business chargeable to tax under this head. Thus a Chamber of Commerce providing lodging facilities to its members would be chargeable to income-tax under this head in respect of the charges, if any, by way of fees or other payment collected from the members for rendering such specific services. The services, the income from which is chargeable to tax, may be those which are rendered in the normal course of the activities of the association or may be outside the scope of such normal activities. If, however, the income is derived as a part of usual contributions or subscriptions and not for the purpose of rendering any specific services to the members concerned, the trade or professional association would not attract liability to tax under this head.

In the case of any persons carrying on a profession, the value of any benefit or perquisite arising to them from the exercise of their profession would be chargeable to tax irrespective of the fact whether such perquisite or benefit is convertible into money or not. For instance, an advocate who in the course of rendering services to his clients at a place other than his normal place of professional work gets any other benefit at the expense of the client, he would be chargeable to tax in respect of that amount too. If the recipient of the benefit or perquisite is an employee of the person from whom the benefit is derived, the value of the perquisite would be chargeable to tax as income from salaries under Section 15 but not as income from business. The provision covers only those cases where the value of the benefit is not taxable under the head salaries and the person deriving the benefit is carrying on a business or profession.

(iv) Export Incentives:

(a) Profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947;

(b) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;

(c) Any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1995, or any profit on transfer of the Duty Entitlement Pass Book Scheme, or any profit on the transfer of the Duty Free Replenishment Certificate.

(v) The value of any benefit or perquisite, whether convertible into money or not, which arises from the carrying on of a business or the exercise of a profession.

(vi) Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm.

However, where any interest, salary, bonus, commission or remuneration or any part thereof has not been allowed to be deducted under Section 40(b), the income under this clause shall be adjusted to the extent of the amount not so allowed to be deducted.

(vii) any sum, whether received or receivable in cash or kind, under an agreement for—
(a) not carrying out any activity in relation to any business, or
(b) not sharing any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services:

Provided that Sub-clause (a) shall not apply to
(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital Gains";
(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on substances that deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Explanation— For the purposes of this clause, —
(i) "agreement" includes any arrangement or understanding or action in concert, —
   (A) whether or not such arrangement, understanding or action is formal or in writing; or
   (B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;
(ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

(viii) Any sum received under a keyman Insurance Policy including the sum allocated by way of bonus on such policy.

Explanation: For the purpose of this clause, the expression "Keyman Insurance Policy" shall have the following meaning:
Life Insurance Policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person.

(ix) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

The income from business to which a person is chargeable under this head represents not the gross receipts from the business but the profits and gains derived therefrom. For instance, in the case of a businessman, the gross sale proceeds would not be the basis for levying tax but it is net profit or the profit or gain as determined under the Income-tax Act that would be the basis of chargeability. The
profits which are chargeable for this purpose should be taken to be those profits and gains which are computed on the basis of ordinary principles of commercial accounting or trading subject, however, to the exceptions provided by the law itself. The provisions of the Income-tax Act contained in Sections 28 to 44D regulate the method of computing income from business. But the Income-tax Act has not prescribed any specific method for determining the taxable profit for each business separately. The profits and gains of a business are to be computed in accordance with the method of accounting regularly and consistently followed by the assessee or the method of accounting followed is such that income, profits or gains cannot properly be ascertained therefrom, the income-tax authorities are entitled to compute the income of the assessee on such basis and in such manner as they deem fit. An assessee, for the purpose of his business, may follow the cash system of accounting or the mercantile system of accounting. Both these methods are well recognised for income-tax purposes and the tax authorities are bound by the method adopted by the assessee. The tax authorities are not also empowered to reject the method of accounting regularly followed by the assessee for the purpose of his business except, however, in cases where the method is not correct, complete or scientific. An assessee may also follow the hybrid system of accounting for his business or profession. The hybrid system is the combination of the cash system and the mercantile system. This is mostly done in the case of professional men who follow cash system for their receipts and mercantile system for their payments.

The income that is chargeable to tax under this head may be realised by the assessee in cash or kind. In cases where the profit is realised in any other form than cash, the market value of the commodity received as income should be taken to be the quantum of income chargeable to tax. Even in cases where an assessee is in receipt of money from his clients or other persons who are under no obligation to make such payment, the assessee would still be chargeable to tax if these monies were received by him in the ordinary course of business or profession. For instance, any amount paid to a Chartered Accountant by a person who has not been his client but who has been benefitted by his professional service to another, would be assessable as the Chartered Accountant’s income from profession.

The person carrying on the business or profession would be chargeable to tax under this head regardless of the fact that the profits or gains made by him ultimately go to the benefit of some other person or to the business community or public body as a whole. In other words, the subsequent application of the money derived by way of income from business is immaterial for the purpose of assessment of the businessman. The chargeability to tax under Section 28 is based primarily upon the condition that the assessee must have carried on a business or profession at any time during the accounting year, though not necessarily throughout the accounting year. But there may be a few cases (e.g. deemed profits taxable under Section 41) where even if no business is carried on during the accounting year, the assessee would still be chargeable to tax. In order to be taxable in respect of the income of a business it is not essential that the business must be carried on by the same person who is the owner thereof. Even if the owner authorises some other person to carry on the business on his behalf or the owner is deprived by the court under certain circumstances of the right to carry on his own business, the owner will still be taxable under this head. Similarly, it is not only the legal ownership but also the beneficial ownership that has to be considered. In this connection it has to be kept in view, as to
who is the actual recipient of the income which is going to be taxed. For example, where a business is acquired for the benefit of a company which is going to be incorporated and the promoters carry on the business and earn profits during the period prior to the incorporation, if the company accepts the action of the promoters and receives from them the past profits made prior to its incorporation, the company shall be assessable under this section in respect of such profits although before the incorporation of the company the promoters were the legal owners of this business yet as the company was the beneficial owner (as it has actually received the profits) of the business, it will be assessable on these profits. [CIT v. Bijli Cotton Mills Ltd. (1953) 23 ITR p. 278]. The tax is leviable on the person to whom the profits accrue or by whom the profits are received. No tax can be levied on a benamidar in whose name the business transactions are effected and who is not really entitled to the profits. [C.I.T. v. Thaver Bros. (1934) 2 ITR p. 230].

While profit motive is indicative of and is not the sole test for determination of the fact that the adventure of an assessee is in the nature of trade and consequently constitutes a business, it is immaterial whether the business is legal or illegal. In other words, the taxability of the income from business does not in any way depend upon or is affected by the taint of illegality in the income or the sources. Income derived from illegal activities is as much chargeable to tax as income from other operations. The fact that the person who carried on the illegal activities is punishable under the appropriate law, does not exclude him from the liability to income-tax. However, the loss arising directly in the course of an illegal business is deductible as business expenditure in computing the profits from that business, [C.I.T. v. S.C. Kothari (1971) 82 I.T.R. p. 794 (S.C.) and C.I.T. v. Piara Singh (1980) 124 I.T.R. p. 40 (S.C.)]. There may be assesses who carry on business without the primary object of making profits (e.g., a co-operative society which tries to cater to the needs of its members without the object of making maximum profits). Even in such cases, if profits arise from the business carried on by the assessee and such profits are incidental to the business, the assessee would still be taxable. Therefore, profit motive is not the only test of determining the taxability of income from any activity constituting business or profession.

A taxpayer is entitled to carry on as much number of businesses as he can, both in his own name and in the name of others. The profits and gains of all businesses or professions would be assessable under this head. But the profit of each business must be computed separately from one another and the deductions and allowance permissible to each business must be allowed against the income derived therefrom. The income chargeable under this head is the aggregate of the net result of the various business or businesses or profession(s) carried on during the accounting year. Thus, the loss arising from one business would be set off against income from another business falling under the same head and the net result after such set off would alone be assessable income under this head. The law does not permit an assessee to club all the sources of his income under the head and claim a composite amount towards expenses and losses attributable to all the businesses. If an assessee has incurred an item of expenditure for the purpose of many businesses the expenditure in question will have to be apportioned against each business for the purpose of allowance.
5.18 PROFITS AND LOSSES OF SPECULATION BUSINESS

The term speculation has not been exhaustively defined in the income-tax Act, but it normally denotes the meaning commonly assigned to it in commercial practice. However, Section 43(5) defines the expression “speculative transaction” as a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Where a company (other than banking or financial company) deals in shares of other companies, the income from such business is treated as income from speculative business. However, the following four forms of transactions have been specifically excluded from the scope of speculative transactions:

(i) A contract in respect of raw-materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(ii) A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(iii) A contract entered into by a member of a forward market or a stock exchange in the course of any transaction which is in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as such member.

(iv) An eligible transaction in respect of trading in derivatives referred to in Clause (aa) of Section 2 of the Securities Contracts (Regulation) Act, 1956 carried out in a recognized stock exchange.

Therefore, in all cases where actual delivery or transfer of the commodity takes place, the transaction would not be a speculative transaction, however highly speculative its nature may be.

The above-mentioned four items constitute exceptions provided by the Act whereby transactions such as hedging contracts entered into by manufacturer and merchants in the course of their business to guard against the losses through price fluctuations are excluded from the definition of speculative transactions.

Case Laws:

1 In the case of Nirmal Trading Co. v. C.I.T., where the assessee settled the transactions by handing over delivery orders and payment of cheques but there was no evidence that actual delivery of goods was ever effected, the Supreme Court held that the transactions were ‘speculative transactions’ [1980, 121 I.T.R. p. 54 (S.C.).]


A claim based on a breach of contract does not come within the meaning of
‘Contract settled’. ‘Contract settled’ means a contract settled before breach. Damages for breach of contract are, accordingly, not losses from speculative transactions.


Where the liability of an assessee on account of speculative loss is waived by the creditor, it is chargeable under Section 41(1) but it will be treated as speculative income.

Explanation 2 to Section 28 specifically provides that speculation business must be deemed to be distinct and separate from any other business carried on by the same assessee regardless of the fact that the speculation is in shares and securities or commodities. The treatment of speculation business as being separate and distinct from other businesses is essential because of the provisions of Section 73 which provides that losses incurred in speculation business can be set off only against income from speculation either in the same year or in the subsequent 8 years. Since speculation losses cannot be set-off against any other income either in the same year or subsequent years, although all the types of losses or income fall for assessment under the same head ‘profits and gains of business or profession’, it is obligatory to treat speculation losses separately.

### Test Your Knowledge

Transactions such as hedging contracts entered into by manufacturer and merchants in the course of their business to guard against the losses through price fluctuations are included in speculative transactions.

(a) True  
(b) False

Correct answer: false

5.19 HOW PROFITS AND GAINS ARE COMPUTED

Section 29 of the Income-tax Act provides that the profits and gains of any business or profession which are chargeable to tax under Section 28 must be computed in accordance with the provisions contained in Sections 30 to 43D. The various sections beginning from 30 to 43C deal with the allowance for expenses which are incurred for the purpose of the business including allowance for depreciation, development rebate, development allowance, rehabilitation allowance and amortisation of certain other capital expenses. There are specific provisions for disallowance of expenses and also for charging to tax certain items as deemed income from business although they may not represent income under the accounting concept. But these sections deal primarily with expenses and not with the losses which are incidental to the carrying on of the business or trade. Consequently, losses incidental to trade which are of revenue nature are to be allowed as a deduction under Section 29 on ordinary principles of commercial accounting for the purpose of computing the taxable income from business. The question whether a particular item of loss is incidental to the trade or not would necessarily depend upon the facts and circumstances of each case. The deduction which is permissible under Section 29 is
only in respect of revenue losses which are incidental to trade. Losses of a capital nature although incidental to the trade or business are not deductible under Section 29.

Some of the items of losses incidental to trade which are deductible under Section 29 are the following: losses due to embezzlement by the employee, losses arising out of theft or robbery, losses resulting from destruction of assets, loss of stock-in-trade in transit or by fire, loss of stock due to ravages of white-ants, loss of business assets by enemy action during war, loss resulting from negligence or fraud on the part of employees, loss of money advanced by sugar manufacturing company to cane-growers in the ordinary course of business, etc. But the tax paid by a businessman in respect of the income of a non-resident for which he is assessed as the agent of the non-resident by virtue of the business connection between him and the non-resident would not be deductible as a loss incidental to trade when the tax paid by the assessee could not be recovered by him from the non-resident. This is because of the fact that the payment of tax of some other person cannot be the purpose of the business of the assessee and consequently such payment would not be deductible when it becomes irrecoverable. Bad debts arising in the normal course of trade are not deductible under the provisions of this section since Section 36 (1)(vii) and (viia) specifically allows deductions in respect of bad debt subject to certain conditions. Where a businessman stands surety for the debt of other persons and such a guarantee is not in the ordinary course of his business or for the purpose of his trade, any payment made by the businessman to a third party as a result of the guarantee would not be deductible as a business loss except, however, in cases where the contract of guarantee is entered into by the assessee in the ordinary course of business or profession or pursuant to a trade or custom of which mutual accommodation is the essence. For instance, it is a common practice in many business circles where traders stand surety for one another. If a loss arises as a result of such surety, the amount of such loss could be allowed as a deduction. It is possible that the amount of loss is not precisely known to the assessee due to the fact that he is not in a position to ascertain the exact amount of such loss. In such cases, the Income-tax authorities are bound to estimate the amount of loss incurred by the assessee and allow the same as deduction. In all cases, it is essential that the loss which is sought to be claimed and allowed as being incidental to the trade, must be of a revenue nature, i.e., loss of stock-in-trade or any other current asset of the business. For instance, in the case of a Bank, the cash in hand lost by it on account of robbery or burglary would be allowable as a deduction. But the allowability of the loss is subject to the condition that loss is incidental to the trade and is unavoidable so far as the businessman is concerned. If the assessee could have averted the loss when the loss could have been foreseen, he would not be entitled to the deduction of the loss when it is incurred by him voluntarily. The deduction in respect of a loss can be claimed at the moment the taxpayer is sure that he has no chances of recovery or recouping the amount and normally writes off the amount of loss in his books of account. However, the presence or absence of entries in the books in regard to the write off of a loss, would not be conclusive proof as to whether the assessee actually incurred any loss or not. [Nagri Mills Co. Ltd. v. C.I.T. (1981) 131 ITR p. 257 (Guj.).]

Similarly, for allowing the claims of deduction under Sections 30 to 36, the condition whether the expenditure is capital or revenue in nature, is immaterial. [Nathmal Bankat Lal Parikh and Company v. C.I.T. (1980) 122 I.T.R. p. 169].
Computation of Profits of Business or Profession

The profits and gains of business or profession are computed in accordance with the provisions contained in Sections 30 to 43D. Sections 30 to 37 contain those deductions which are expressly allowed while computing profits of business or profession. Section 40 provides those expenses which are allowed on the basis of general commercial principles while computing profits of business or profession. It is necessary to know those principles before studying the deductions expressly allowed while computing profits of business or profession.

The general commercial principles are as under:

1. Profits should be computed according to the method of accounting regularly employed by the assessee, provided that actual profit can be ascertained by this method, whether on receipt basis or accrual basis.

2. Only those expenses and losses are allowed as deductions which were incurred or sustained during the relevant previous year and related to business.

3. These losses and expenses should be incidental to the operation of the business. For example, embezzlement by an employee during the course of business is a loss incidental to the business. Similarly, loss from dacoity in a bank is also a loss incidental to the business of a bank.

4. If a business has been discontinued before the commencement of the previous year, its expenses cannot be allowed as deduction against the income of any other running business of the assessee.

5. There are some essential expenses, though neither expressly allowed nor disallowed, but are deductible while computing the profits of business or profession on the basis of general commercial principles provided that these are not expenses or losses of a capital nature or personal nature.

6. Any expenditure incurred in consideration of commercial expediency is allowed as deduction.

7. Deduction can be made from the income of that business only for which the expenses were incurred. The expenses of one business cannot be charged against the income of any other business.

Rules for Adjustment of Profit and Loss Account prepared by the Assessee

The Profit and Loss Account prepared by the assessee is not correct from the income tax point of view as (i) several such expenses are charged to it which are wholly or partly inadmissible under the Income-tax Act, (ii) some admissible expenses are omitted from it, (iii) some taxable incomes are not credited to it, and (iv) some such incomes are credited which are either not taxable from taxable point of view, so that the profit taxable under the head ‘Business or Profession’ is determined correctly. The following are the rules for adjustment of the Profit and Loss Account:

(i) Those expenses or losses which are charged to Profit and Loss Account but are not allowed under the Income-tax Act, should be added to the profit, as shown by the Profit and Loss Account prepared by the assessee. If any expense is partly disallowed, only the disallowed part of it shall be added to the profit.
(ii) If any admissible expenses are omitted from Profit and Loss Account, they should be deducted from the above profit.

(iii) If some taxable incomes are omitted from the Profit and Loss Account they should be added to the above profit.

(iv) If some such incomes have been credited to the Profit and Loss Account which are either not taxable under the head ‘Business or Profession’ or are not taxable at all, they should be deducted from the above profits.

Note: If instead of profit there is loss as per the Profit and Loss Account, the above rules shall be reversed, i.e. items to be added shall be deducted and those to be deducted shall be added. If after making some adjustments the profit is converted into loss, the above rules shall be reversed for subsequent adjustments.

The above rules can well be illustrated with the help of the following statements:

| Computation of Income under the head “Profits and Gains from Business or Profession” |
|-----------------------------------------|---------------------------------|
| Profit as per P&L A/c                   | ...........                    |
| Add:                                    |                                 |
|   (i) Expenses or losses disallowed but charged in P&L A/c | |
|   (ii) Incomes taxable as business income but not credited to the P&L A/c | |
|   (iii) Expenses in excess of the allowed amount charged in P&L A/c | |
|   (iv) Undervaluation of closing stock or overvaluation of opening stock. | |
| Deduct:                                  |                                 |
|   (i) Expenses or losses allowed but not debited to P&L A/c | |
|   (ii) Incomes not taxable as business income but credited to the P&L A/c | |
|   (iii) Incomes exempt from tax but credited in P&L A/c | |
|   (iv) Overvaluation of closing stock and undervaluation of opening stock. | |
| Taxable Income from Business or Profession | ...........               |

5.20 DEDUCTIONS ALLOWABLE

(A) Rent, Rates, Taxes, Repairs and Insurance for Buildings (Section 30)

In respect of the business premises used by the assessee, the deduction is available in computing the income from business for the following items:

(a) Where the premises are occupied by the assessee in his capacity as tenant, the rent paid for such premises would be deductible. In cases where the assessee has also undertaken to bear the cost of repairs as part of the terms of his tenancy agreement, the amount of expenses actually incurred by him on account of repairs would also be deductible.

(b) If the assessee occupies premises not in the capacity of a tenant but as its owner, a lessee or licensee, the expenses incurred on current repairs to the premises would be deductible.

(c) The assessee is also entitled to deduct any amount paid by him on account of land revenue, local rates or municipal taxes in respect of the premises.

Explanation.—For the removal of doubts, it is hereby declared that the
amount paid on account of the cost of repairs referred to in sub-clause (i), and the amount paid on account of current repairs referred to in sub-clause (ii), of clause (a), shall not include any expenditure in the nature of capital expenditure.”

(d) Any premium paid in respect of insurance against risk of damage or destruction of the premises, is also deductible.

### Deduction of depreciation on the basis of usage:

Section 38 of the Act provides for the allowance of the proportionate amount of the expenses in this regard. It is possible that an assessee who has taken a building on rent for business purposes may sublet a part of the same. In such cases, the deduction allowable under the section would be a sum equal to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The allowability of rent payable in respect of business premises does not in any way depend upon the taxability or otherwise of the rental income in the hands of the owner of the building. If the assessee is the owner of the building which is used for business or professional purposes, no deduction would be available in respect of the notional rent which would otherwise have been payable. But depreciation under Section 32 would be available in respect of such buildings. In cases where a firm carries on a business in the premises owned by one of its partners the rent payable to the partner would be an allowable deduction since the firm and the partners are separate entities.

In cases where the assessee uses the premises partly for his business or professional purposes and partly for other purposes the deduction allowable under this section is a sum proportionate to that part of the expenses which are attributable to the premises used for business or professional purposes.

(B) Repairs and Insurance of Machinery, Plant and Furniture (Section 31)

Income from business or profession should be computed after allowing deductions under Section 31 in respect of repairs and insurance of the machinery, plant or furniture used for the purpose of business or profession. The deduction allowable would cover the amount of expenses on account of current repairs and also the amount of any premium paid in respect of insurance of the machinery, plant or furniture against any risk of damage or destruction thereof. The assessee is entitled for deduction in respect of repairs and insurance of these assets only if these assets have been actually used for the purpose of the business of the assessee during the accounting year the profits of which are subjected to tax. Thus, if the assets are used in some business, income of which is not chargeable to tax, the assessee cannot claim deduction in respect of these expenses against the income from some other business, the profits of which are taxable. It is not essential that the assessee must be the owner of these assets in order to claim deduction in respect of these expenses. Even if these assets have been taken on hire, the assessee would still be entitled for the deduction. On the other hand, if the assessee is the owner of the machinery, plant or furniture and these assets are held as the assets of the business but have not been made use of for the purposes of the business during the accounting year, no deduction would be available. But the allowance of these expenses does not in any way get affected by the fact that these assets are used only for a part of the accounting year in the business of the assessee. The allowance
for repairs covers not only the expenses of ordinary maintenance and replacement of the small parts but also of the renewal or renovation of the asset. However, the expenses incurred towards replacement or reconditioning of the machinery or plant or furniture, would not be allowable under this section because the cost of replacement or reconditioning of an asset would be an expenditure of a capital nature since it results in the acquisition of a capital asset or benefit of an enduring nature. In cases where the assessee incurs expenses in respect of repairs of the plant and machinery of a large sum in one year and these repairs relate to a number of years which have not been actually carried out, the deduction allowable under this section would be only in respect of the expenses on current repairs although the expenses in regard to arrears of repairs may be deductible under Section 37(1).

The simple test that must be constantly borne in mind is that as a result of the expenditure which is claimed as an expenditure for repairs, what is really being done is to preserve and maintain an already existing asset. The object of the expenditure is neither to bring a new asset in to existence, nor to obtain any fresh advantage. [New Shorrock Spinning and Manufacturing Co. Ltd. v. C.I.T. (1956) 30 I.T.R. p. 338]. The replacement of the old diesel engine by a new engine in a motor van used for business purposes was done with a view to preserve and maintain the asset in existence and, as no enduring benefit was derived by the assessee, the expenditure was allowed. [Nathmal Bankat Lal Parikh and Company v. C.I.T. (1980) 122 I.T.R. p. 168].

(C) Depreciation (Section 32)

In computing income from business, one of the most important items of allowances is the allowance for depreciation provided by Section 32 of the Income-tax Act. The deduction towards depreciation is very essential to arrive at the income of the assessee and also to amortise the capital cost of the amount invested in buildings, machinery, plant and furniture. The purpose of allowing depreciation is to provide in course of time for the replacement of asset with the help of the capital cost of the asset which is allowed to be amortised over a period of time. The provisions for allowing depreciation are contained in Section 32 and are regulated under Rule 5 of the Income-tax Rules. The rates of depreciation are also provided in the Income-tax Rules.

Conditions for allowability of Depreciation:

In order that the depreciation is allowable, the following conditions must be fulfilled:

(a) Classification of Assests: The assets in respect of which depreciation is claimed must be buildings, machinery, plant or furniture. In addition to these tangible assets intangible assets like know how, patent rights, copy rights, trade marks, licences, franchises or any other business or commercial right of similar nature acquired on or after 1.4.1998 are eligible for depreciation. These intangible assets will form a separate block of assets. As and when any capital expenditure is incurred by an assessee on acquiring such intangible assets, the amount of such expenditure will be added to the block of intangible assets and depreciation will be claimed on the written down value at the end of financial year. While taking into account the depreciation allowance in respect of a building, only the cost of the building is to be taken into account but not the cost of the land on which the building is erected because the land does not suffer any depreciation as a result of wear and tear or its usage. Thus, the term building used in this context refers only to
the super-structure and not the land on which it is erected [C.I.T. v. Alps Theatre (1967) 65 I.T.R. p. 377 (S.C.)]. Roads within a factory compound form part of building which is used for the purpose of the business and as such are entitled to depreciation. Similarly, residential quarters provided to the employees are used for the business in the sense that they are used for and such user is incidental to the carrying on the business. Therefore, the roads to such residential quarters are also entitled to depreciation at the rates applicable to first class building [C.I.T. v. Kalyani Spinning Mills Ltd. (1981) 128 I.T.R. p. 279 (Cal.)]. However, the M.P. High Court has held that expenditure incurred on construction of metal roads for approach to trenches to dump the waste and night soil, is capital expenditure. Moreover, such roads are not plant and machinery. Hence, the assessee is not entitled to depreciation on the cost of the metal roads [Indore Municipal Corporation v. C.I.T. (1981) 132 I.T.R. p. 540 (MP)].

Plant

The term ‘plant’ for the purpose of allowance of depreciation has been defined in Section 43(3) to include ships, vehicles, books, scientific apparatus and surgical equipments used for the purposes of the business or profession. However, on the basis of cases decided by the courts, the following are also included in the term ‘plant’:

(i) In the case of a hotel, pipe and sanitary fittings [C.I.T. v. Taj Mahal Hotel (1971) 82 I.T.R. p. 44 (S.C.)].
(ii) In the case of electric supply company, mains service lines and switch gears [C.I.T. v. Warner Hindustan Limited].
(iii) Well.
(iv) In the case of manufacturer of oxygen, gas-cylinder for storing gas.

Since the definition of plant is inclusive in nature, it should be taken to cover all goods and chattels, whether fixed or moveable which a businessman may keep for the purpose of employment in his business with some degree of certainty and duration of time.

<table>
<thead>
<tr>
<th>However, following are some of the instances which are not held as plant:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Warehouses for storage purposes</td>
</tr>
<tr>
<td>2. Horses</td>
</tr>
<tr>
<td>3. Human body</td>
</tr>
<tr>
<td>4. Bed of River</td>
</tr>
<tr>
<td>5. Water storage tanks used for storing water by the supplier for irrigation purposes.</td>
</tr>
<tr>
<td>6. Cinema Theaters</td>
</tr>
<tr>
<td>7. Hotel Building</td>
</tr>
</tbody>
</table>
Moreover, 'tea bushes', 'livestock', buildings or furniture and fittings have been excluded from the definition of plant w.e.f. assessment year 1962-63.

(b) Ownership Vs. lease:

Depreciation is allowable to the assessee only in respect of those capital assets which are owned by him. In case of a building, the assessee must be owner of the super-structure and not necessarily of the land on which it is constructed. If the assessee is only a tenant of the building but not its owner he is not entitled for allowance in respect of depreciation thereof. Where the land on which the building is constructed has been taken on lease by the assessee, the allowance of depreciation would be admissible only if, according to the lease deed, the assessee is entitled to be the owner of the super-structure. The fact that as part of the terms of the lease deed, the building, after expiry of the lease is to be transferred to the lessor of the land would not affect the allowance for depreciation.

In the case of assets acquired on hire-purchase e.g., plant and machinery taken on hire, the assessee would not be the owner thereof and consequently would not be entitled for depreciation in respect of the same. But if the plant and machinery had been acquired on instalment basis, the assessee becomes the owner of the assets the moment the purchase or sale is concluded and consequently is entitled to depreciation although a part or whole of the price is payable in future.

(c) Used for the purpose of Business or Profession:

The allowance for depreciation is subject to the condition that the assets on which depreciation is claimed are actually used by the assessee for the purposes of his business or profession during the accounting year. The allowance for depreciation, however, is not subject to the condition that the asset in question must be used throughout the relevant accounting year in order to enable the assessee to claim depreciation. Thus, even if the asset is used for a very small fraction of the accounting year, the assessee would be entitled to depreciation in respect of the full amount allowable as if the asset had been used throughout the accounting year. Even in the case of seasonal factories (e.g., sugar manufacturing companies), the full amount of depreciation is allowable if the asset had been used at any time during the accounting year in the factory. In cases where the depreciable asset is used partly for business purposes and partly for other purposes, the deduction towards depreciation allowable under Section 32 would be of a sum proportionate to the depreciation allowance to which the assessee would have otherwise been entitled, in the year in which the depreciable asset is sold, destroyed, discarded or demolished, no depreciation at the rates prescribed in the Income-tax Rules would be allowable.

(d) Amount of deduction shall not exceed actual cost: The total amount of all items of depreciation allowance allowed to the assessee from year to year shall not exceed the actual cost of the block of assets to the assessee.

(e) No deduction on sold assets: No depreciation is allowable in respect of the depreciable asset if the asset concerned is sold, destroyed, discarded or demolished in the same year in which it was acquired.
(f) In order to be entitled to allowance towards depreciation, the assessee must furnish the prescribed particulars contained in Annexure ‘B’ attached to the Form of the Return of Income-tax. Any failure on the part of the assessee to furnish fully and truly all material facts, including the particulars prescribed for this purpose, would entitle the income-tax authorities to refuse to allow deduction towards depreciation.

(g) The Finance Act, 1995 has deleted w.e.f. assessment year 1996-97 the provision pursuant to which one could write off the entire cost of plant and machinery in the very first previous year in which it was put to use provided its actual cost did not exceed ₹ 5,000, to prevent the widespread misuse of the concession.

(h) The Finance (No. 2) Act, 1996 has rationalised the depreciation provisions, inter alia as follows:

In case of joint ownership of an asset, depreciation would be allowed to each of the owner in proportion to the contribution to the total cost of the asset;

and

In case of amalgamation during the course of a previous year, the amalgamating company and the amalgamated company shall share the depreciation in proportion to the number of days during which the assets remained under their respective ownership.

Similarly, in case of demerger during the course of a previous year (w.e.f. 1.4.2000), the demerged company and the resulting company shall share the depreciation in proportion to the number of days during which the assets remained under their respective ownership.

Basis of depreciation:

The depreciation is provided in respect of “Block of assets” which, as per Section 2(11): means a group of assets falling within a class of assets, being tangible assets such as buildings, machinery, plant or furniture and intangible assets, being know-how, patents, copyrights, trademarks, licences, Franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed. Moreover depreciation is now allowed on the written down value of all types of assets. Again, no deduction shall be allowed under this clause in respect of any motor car manufactured outside India, where such motor car is acquired by the assessee after the 28th day of February, 1975, and is used otherwise than in a business of running it on hire for tourists or,

(a) outside India in his business or profession in another country, and

(b) in respect of any machinery or plant if the actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under Section 42 of the Act.

For the purposes of depreciation, the following terms are important:

(i) Actual Cost

(ii) Written Down Value

(iii) Classification of Depreciation
(i) Actual Cost

For computing depreciation, actual cost is the basis in the case of all assets for the first year when the assets are put to use for the purpose of the business. Subsequently, even in the case of depreciable asset when the written down value is to be ascertained for the purpose of allowing depreciation, the written down value should be taken to be the book value of the asset after allowing deduction in respect of the depreciation allowable under the Income-tax Act from the actual cost of the asset concerned. The actual cost of an asset is essential for the purposes of allowing depreciation also because of the fact that the aggregate of all the items of depreciation allowable to an assessee in respect of any depreciable asset shall not exceed the amount of its actual cost.

The actual cost of an asset to the assessee is normally the amount of capital expenditure incurred in respect of the acquisition, installation, etc., of the asset and also the expenses, if any, incurred by him to make the asset ready for the purpose of its use in the business. Thus, capital expenditure relating to the installation of machinery or plant, its design, etc., would form part of the actual cost of the machinery although such expenses may be incurred by the assessee subsequent to the date of its acquisition. It has been held that preliminary expenses of revenue nature necessary for putting plant and machinery in working condition are part of actual cost of plant and machinery. [Shree Vallabh Glass Works Ltd. v. C.I.T. (1981) 127 I.T.R. p. 37 (Guj.).] However, if a factory of an assessee is shifted to new site, the expenses of shifting the depreciable asset or its installation would be capital expenses and would not form part of the actual cost, because no beneficial asset was acquired or improvement made in the capital assets. [Sitalpur Sugar Works v. C.I.T. (1963) 49 I.T.R. p. 160 (S.C.).] Where a plant is constructed or acquired out of borrowed money by a newly started company, interest paid on the loan upto the date of commencement of production will be capitalised and treated as part of the actual cost of the plant on which depreciation and investment deposit benefits will be allowed. [Challapali Sugar v. C.I.T. (1973) 98 I.T.R. p. 167 (S.C.)]

Definition of Actual Cost:

The expression ‘actual cost’ has been defined in Section 43(1) of the Act to mean that actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. For instance, if an assessee gets a subsidy from the Government for the purchase of a particular item of machinery, the actual cost of the machinery to the assessee would be total of the purchase price and the expenses in regard to installation etc. minus the subsidy received from the Government. However, where any amount has been received as compensation for low output of defective machinery, it will be a revenue receipt and assessed to tax but it will not be deducted in computing actual cost of machinery. [C.I.T. v. Rohtas Industries Ltd. (1981) 130 I.T.R. p. 292 (Cal.).] Thus, the actual cost of the asset as shown in the books will be different from the actual cost on the basis of which depreciation is allowable.

The provisions of Section 43(1) of the Act clarify that the actual cost of depreciable asset should be determined in the following circumstances as indicated below:
(a) Assets used in business after it ceases to be used for Scientific Research:

In cases where the depreciable asset is used for the business after it ceases to be used for scientific research related to that business and a deduction has been allowed in respect of expenditure on scientific research under Section 35, the actual cost of the asset to the assessee should be taken to be the original cost to the assessee minus the amount of any deduction under Section 35 of the Act, originally allowed.

Note: If capital expenditure for scientific research is incurred after 31-3-1967, the whole of such expenditure is deductible for the relevant previous year. Hence, the cost of such asset for depreciation purposes shall be nil.

(b) Assets acquired by way of gift or inheritance:

In cases where the depreciable asset is acquired by the assessee by way of gift or inheritance, the actual cost of the asset to the assessee shall be the actual cost to the previous owner, as reduced by:

(a) the amount of the depreciation actually allowed to the donor or predecessor in respect of any previous year relevant to the assessment year commencing before the 1st day of April, 1988, and

(b) the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988, as if the asset was the only asset in the relevant block of assets.

In case where a portion of the cost of an asset is acquired by the assessee has been met directly or indirectly by the Central Government or State Government or any authority established under any law, or by any other person, in the form of subsidy or grant or reimbursement, then in case where the subsidy is directly relatable to the asset such subsidy shall not be included in the actual cost of the asset. In case where such subsidy or grant or reimbursement is of such a nature that it cannot be directly relatable to any particular asset, the amount so received shall be apportioned in a manner that such asset bears to all assets in respect of or with reference to which the subsidy or grant or reimbursement is so received and such subsidy shall not be included in the actual cost of the asset.

(c) Assets transferred to reduce tax liability:

In cases where prior to the date of acquisition by the assessee the depreciable asset was at any time used by any other person for the purpose of his business or profession and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was to secure a reduction of liability to income-tax by claiming depreciation with reference to the enhanced cost, the actual cost of the asset to the assessee should be taken at such amount as the Assessing Officer may, with the prior approval of the Deputy Commissioner, determine having due regard to all the circumstances of the case. For instance, if X transfers his machinery on 1.1.1990 to Y for a sum of ₹ 6.00 lakhs while the actual cost of the asset and the written down value thereof on that day to X are ₹ 3.00 lakhs and ₹ 1.00 lakh respectively, it may be inferred that the transfer by X to Y is made with idea to enable Y to claim depreciation on ₹ 6.00 Lakhs while the market
value of the asset on the date of sale by X to Y may be ₹ 4.00 lakhs only. In such a case, the Assessing Officer would be entitled to allow depreciation to Y on the basis of the cost which may be determined by him to be ₹ 4.00 lakhs instead of ₹ 6.00 lakhs as claimed by Y.

(d) Assets earlier transferred re-acquired by the Assessee:

There may be cases where depreciable asset would have once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter it might have ceased to be his property by reason of its transfer or otherwise. If such a depreciable asset is re-acquired by the assessee himself, the actual cost of the asset should be taken to be the least of either -

(a) actual cost of the asset to the assessee when it was first acquired by him minus (i) the depreciation actually allowed to him in respect of any previous year relevant to the assessment year commencing before the 1st day of April, 1988, and (ii) the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988, as if the asset was the only asset in the relevant block of assets or.

(b) the actual price for which the asset is re-acquired by him.

(e) Building brought into use for business purpose subsequent to its acquisition:

In cases where a building which was previously the property of the assessee is brought into use for the purpose of his business or profession after 28-2-1946, the actual cost of the building to the assessee should be taken to be the original cost of the building minus the amount equal to the depreciation calculated at the rate in force at that date which would have been allowable had the building been used for purposes of the business or profession ever since the date of its acquisition by the assessee.

(f) Asset transferred by by holding company to 100% subsidiary company or vice-versa:

In cases where any depreciable asset is transferred by an Indian holding company to its wholly owned subsidiary or vice versa, then the actual cost of the transferred asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the transferred capital asset for the purposes of its own business.

(g) Asset transferred under a Scheme of Amalgamation:

In the case of an amalgamation as defined in Section 2(1B) of the Act, if any depreciable asset is transferred by the amalgamating company to the amalgamated company, which is an Indian company as defined in Section 2(26) of the Act, the actual cost of the transferred capital asset to the amalgamated company must be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business.

(h) Asset transferred to the resulting company in case of demerger:

In case of demerger, any capital asset is transferred by the demerged company
to the resulting company and the resulting company is an Indian company, the actual cost of the transferred capital asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.

Provided that such actual cost shall not exceed the written down value of such capital asset in the hands of the demerged company.

(i) Interest Pertaining to Post Acquisition Period:

Where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost of such asset.

(j) Actual Cost of Cenvetable Asset:

Where an asset is or has been acquired on or after the 1st day of March, 1994 by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 (51 of 1975) in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944.

(k) Asset acquired where portion of cost met by some other person:

Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee:

Provided that where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee.

(l) Asset acquired by non-resident outside India but for business or profession in India:

Where an asset which was acquired outside India by an assessee, being a non-resident, is brought by him to India and used for the purposes of his business or profession, the actual cost of the asset to the assessee shall be the actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee.

(m) Asset acquired under scheme of corporatisation of Recognised Stock Exchange:

Where any capital asset is acquired by the assessee under a scheme for
corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization.

(n) **Capital Asset on which deduction has been allowed or allowable u/s 35AD:**

The actual cost of any capital asset on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be treated as nil:

(a) in the case of such assessee; and

(b) in any other case if the capital asset is acquired or received:

(i) by way of gift or will or an irrevocable trust;

(ii) on any distribution on liquidation of the company; and

(iii) by such mode of transfer as is referred to in clauses (i), (iv), (v), (vi), (vib), (xiii) and(xiv) of section 47.

Depreciation is not allowed in case of a foreign car acquired by the assessee after 28th day of February, 1975 and used otherwise than in a business of running it on hire for tourists or is not used outside India in business or profession carried on by the assessee in another country.

In cases where the assessee acquires the business of another, the original cost of the depreciable asset to the assessee would be the value at which assets are taken over by him and not the original cost of those assets to the previous owner of the business. However, in case of succession by inheritance or gift where the actual cost to the assessee is taken to be the actual cost to the previous owner as reduced by the amount of depreciation actually allowed under the Act. In cases of partition of a HUF, if depreciable assets are divided amongst the members thereof at a genuine valuation, the cost of the asset to the member who, after the partition, uses the asset for the purposes of his business should be taken to be the value at which he takes over the asset.

(ii) **Written down value [Section 43(6)]:**

The written down means:

In the case of assets acquired in the previous year, the actual cost of the assets to the assessee.

In the case of assets acquired before the previous year the actual cost of the assets to the assessee less all depreciation actually allowed to him in that Previous Year.

In the case of any block of assets the written down value will be determined as under:

Total of written down value of all the assets falling within a block at the beginning of the previous year relevant to the
assessment year  .......... 
Add:  The actual cost of, any new assets falling in the  
      block, acquired during the previous year  .......... 
Less:  Moneys payable in respect of any asset, falling within  
      that block which is sold, discarded, demolished or  
      destroyed during the previous year together with the  
      amount of scrap value in respect of any asset.  
      The amount of deduction cannot exceed the  
      written down value as so increased  .......... 
Written down value for the assessment year  .......... 
Less:  Depreciation during the previous year relevant  
      to the assessment year  .......... 
Written down value at the beginning of the previous year  
relevant to the next assessment year  .......... 

The addition/deduction as aforesaid may be made for calculating written down  
value for the concerned previous year.

The written down value of any block of assets may be reduced to nil in the  
following cases:

(i) Where money receivable in respect of assets sold or otherwise transferred  
    during the previous year plus the amount of scrap value is more than the  
    written down value at the beginning of the previous year as increased by the  
    actual cost of any new asset acquired.

(ii) Where all the assets in the relevant block are transferred during the year.

Explanation 1: When in a case of succession in business or profession, an  
assessment is made on the successor [under Section 170(2)], the written-down value  
of any asset or block of assets is the amount which would have been taken as its  
written-down value if the assessment had been made directly on the person  
succeeded to.

Explanation 2: Where in any previous year, any block of assets is transferred:

(a) by a holding company to its subsidiary company or by a subsidiary company  
to its holding company and the conditions of clause (iv) or, as the case may  
be, of clause (v) of Section 47 are satisfied; or

(b) by the amalgamating company to the amalgamated company in a scheme of  
amalgamation, and the amalgamated company is an Indian Company, then,  
notwithstanding anything contained in clause (i), the actual cost of the block  
of assets in the case of the transferee company or the amalgamated  
company, as the case may be, shall be the written down value of the block of  
assets as in the case of the transferor-company or the amalgamating  
company for the immediately preceding previous year as reduced by the  
amount of depreciation actually allowed in relation to the said preceding  
previous year.

Explanation 2A: Where in any previous year, any asset forming part of a block of
asset is transferred by a demerged company to the resulting company then the written down value of the block of asset of the demerged company for the immediately preceding previous year shall be reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.

Explanation 2B: Where in a previous year, any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then the written down value of the block of assets in the case of the resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger. Provided that the value of the assets as appearing in the books of account of the demerged company immediately before the demerger exceeds the written down value of such assets in the hands of the demerged company, the amount representing such excess shall be reduced from the written down value of the assets.

Explanation 3: Any unabsorbed depreciation [under Section 32(2)] is deemed to be depreciation actually allowed.

Explanation 4: For the purposes of this clause, the expression "money payable" and "sold" shall have the same meaning as in the Explanation to Sub-section (4) of Section 41.

Explanation 5: For the removal of doubts, it is hereby declared that the provisions of this sub-section shall apply whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income.

Explanation 6: Where an assessee was not required to compute his total income for the purposes of this Act for any previous year or years preceding the previous year relevant to the assessment year under consideration,

(a) the actual cost of an asset shall be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;

(b) the total amount of depreciation on such asset, provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under this Act for the purposes of this clause; and

(c) the depreciation actually allowed under clause (b) shall be adjusted by the amount of depreciation attributable to such revaluation of the asset.

Explanation 7: where the income of an assessee is derived, in part from agriculture and in part from business chargeable to income-tax under the head "Profits and gains of business or profession", for computing the written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee under the head "Profits and gains of business or profession" and the depreciation so computed shall be deemed to be the depreciation actually allowed under this Act.

(iii) Classification of depreciation:

(A) Normal Depreciation [Section 32(1) Rule 5]: Normal depreciation is calculated at the specified percentage on the written-down value of block of assets
(including ocean going ships). Further, where any new machinery or plant is installed during the previous year for the purposes of manufacture or production of any article or thing, and such article or thing (a) is manufactured or produced by using any technology or know-how developed in, or (b) is invented in, a laboratory owned or financed by the Government or owned by a public sector company or university or a duly recognised institution, then such plant or machinery shall be treated as part of block of assets qualifying for depreciation @ 50% of written down value subject to the fulfillment of the following conditions:

(i) the right to use such technology or know-how or to manufacture such article or thing has been acquired from the owner of the laboratory or from any person who has derived the right from such owner;

(ii) the return furnished by the assessee for his income or the income of any other person for which he is assessable for any previous year in which the said machinery or plant is acquired is accompanied by a certificate from the prescribed authority (Secretary, Department of Scientific and Industrial Research, Government of India) to the effect that such technology or know-how is developed in, or the article or thing is invented in such laboratory; and

(iii) the machinery or plant is not used for the purposes of business of manufacture or production of any article listed in the Eleventh Schedule (i.e. low priority articles).

For the purposes of above:

(a) “laboratory financed by the Government” means a laboratory owned by any body (including a society registered under the Societies Registration Act, 1860 (21 of 1860), and financed wholly or mainly by the Government;

(b) “public sector company” means any corporation established by or under any Central, State or Provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956;

(c) “University” means a University established or incorporated by or under a Central, State or Provincial Act and includes an institution declared under Section 3 of the University Grant Commission Act, 1956, to be a University for the purposes of that Act.

(B) Depreciation on Straight line basis: In the case of Power Units [Section 2(1)(i)] (optional to power generating units) From the assessment year 1998-99, an undertaking engaged in generation or generation and distribution of power can claim depreciation on straight line basis on the actual cost of individual asset. But the aggregate depreciation can not exceed the actual cost. Alternatively, such undertaking can claim depreciation, at its option, according to written down value method like any other assessee. The option for this purpose shall be exercised before the due date of furnishing return of income. Once this option is exercised, it shall be final and shall apply to all the subsequent years.

(C) Additional Depreciation [Section 32(1)(iia)]

With effect from Assessment year 2006-07 existing clause (iia) has been
substituted by new Clause (iia) to provide additional depreciation in certain circumstances. The additional depreciation shall be allowed @20% of the actual cost. The conditions and restrictions imposed by this provision are as under—

Under this clause the additional depreciation is available to assessee engaged in the business of manufacture or production of any article or thing in case of any new machinery or plant (other than ships and aircraft) which has been acquired or installed after the 31st day of March, 2005.

Additional depreciation shall not be allowed if (a) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person; or (b) any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house; or (c) any office appliances or road transport vehicles; or (d) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year.

(iv) Calculation of Written Down Value of a block of asset [Section 43(6)]

(a) Find out the written down value on the first day of the previous year (WDV) relevant to the assessment year, of all those depreciable assets on which the depreciation is allowed at the same rate. All such assets are known as "block assets".

(b) The increase in the WDV by the actual cost of any asset falling within that block, acquired during the previous year;

(c) Reduce from the above, the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so that the amount of such reduction does not exceed the written down value as so increased; and

(d) In the case of a slump sale, decrease by the actual cost of the asset falling within the block as reduced by the amount of depreciation that would have been allowable to the assessee for any assessment year, so that the amount of such decrease does not exceed the written down value.

It means if the net consideration of an asset out of the block is less than the balance under (ii), there would be no capital gain. If the net consideration of an asset is more than the balance under (ii) (the value of all assets in the block) the excess shall be deemed to be short term capital gain. If all the assets of the block are sold in the previous year and the net consideration is less than the balance under (ii), the loss shall be deemed to be short-term capital loss.

Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India, 1992 (15 of 1992), the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation.
This may be easily followed by the following example:

Depreciable assets on 1.4.2010 on which the depreciation is available at the same rate of 25%.

<table>
<thead>
<tr>
<th>Asset</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset A</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Asset B</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Asset C</td>
<td>7,00,000</td>
</tr>
<tr>
<td>Total</td>
<td>15,00,000</td>
</tr>
</tbody>
</table>

Less: [Depreciation @ 25% of 15,00,000] (3,75,000)

(i) Written down value on 1.4.2011 of block of assets 11,25,000

Add: Cost of Asset purchased during 2011-12 6,00,000

(ii) Balance 17,25,000

Asset B sold during year 2011-12 (6,75,000)

(iii) Balance 10,50,000

Less: Depreciation for 2011-12 @ 25% of ₹ 10,50,000 (2,62,500)

Written down value of all assets on 1.4.2012 7,87,500

The third proviso to Section 32(1) provides that where an asset being commercial vehicle is, acquired by the assessee on or after the 1st day of October 1998 but before the 1st day of April, 1999 for the purposes of business or profession, the deduction in respect of such asset shall be allowed on such percentage on the written down value thereof as may be prescribed.

Commercial vehicles in this proviso means heavy good vehicle, heavy passenger motor vehicle, light motor vehicle, medium goods vehicle and medium passenger motor vehicle but does not include maxi-cab, motor-cab, tractor and road-roller. (as per their meaning assigned in Section 2 of the Motor Vehicle Act, 1988).

The fifth proviso to Section 32(1) provides that in cases of succession in business or profession, in the case of amalgamation of companies or in the case of demerger of companies depreciation of plant and machinery, buildings and furniture in any previous year shall not exceed the depreciation calculated at the prescribed rate as if the succession, amalgamation or demerger had not taken place. It also seeks to allow the deduction to the predecessor and the successor or the amalgamating company and the amalgamated company or the demerged company and the resulting company in the same proportion as the number of days for which they used the asset in the business or profession.

Section 38(2) provides that where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deduction under Sections 30(a) & (c), 31(i) & (ii) and 32(1)(ii) shall be restricted to a fair proportionate part thereof as may be determined by the Assessing Officer.

This section has not been amended to cover Section 32(1)(i) under which depreciation to electricity undertaking is allowed. Hence, the depreciation for electricity, undertakings claiming deduction under Section 32(1)(i) cannot be proportionately disallowed under Section 38.
Rates at which Depreciation shall be allowable from Assessment Year 2006-2007 Onwards

APPENDIX I

[See rule 5]

Table of Rates at which Depreciation is Admissible

<table>
<thead>
<tr>
<th>Block of assets</th>
<th>Depreciation allowance as percentage of written down value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

PART A

TANGIBLE ASSETS

I. BUILDING [See Notes 1 to 4 below the Table]

1. Buildings which are used mainly for residential purposes except hotels and boarding houses  5

2. Buildings other than those used mainly for residential purposes and not covered by sub-items (1) above and (3) below  10

3. Buildings acquired on or after the 1st day of September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities under clause (I) of sub-section (4) of section 80-1A  100

4. Purely temporary erections such as wooden structures  100

II. FURNITURE AND FITTINGS

Furniture and fittings including electrical fittings [See Note 5 below the Table]  10

III. MACHINERY AND PLANT

1. Machinery and plant other than those covered by sub-items (2), (3) and (8) below  15

2. Motor cars, other than those used in a business of running them on hire, acquired or put to use on or after the 1st day of April, 1990  15
Aeroplanes – Aeroengines

Motor buses, motor lorries and motor taxis used in a business of running them on hire

Commercial vehicle which is acquired by the assessee on or after the 1st day of October, 1998, but before the 1st day of April, 1999 and is put to use for any period before the 1st day of April, 1999 for the purposes of business or profession in accordance with the third proviso to clause (ii) of sub-section (1) of section 32 [see Note 6 below the Table]

New commercial vehicle which is acquired on or after the 1st day of October, 1998, but before the 1st day of April, 1999 in replacement of condemned vehicle of over 15 years of age and is put to use for any period before the 1st day of April, 1999 for the purposes of business or profession in accordance with the third proviso to clause (ii) of sub-section (1) of section 32 [see Note 6 below the Table]

New commercial vehicle which is acquired on or after the 1st day of April, 1999 but before the 1st day of April, 2000 in replacement of condemned vehicle of over 15 years of age and is put to use before the 1st day of April, 2000 for the purpose of business or profession in accordance with the second proviso to clause (ii) of sub-section (1) of section 32 [see Note 6 below the Table]

New commercial vehicle which is acquired on or after the 1st day of April, 2001 but before the 1st day of April, 2002 and is put to use before the 1st day of April, 2002 for the
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>purposes of business or profession [see Note 6 below the Table]</td>
<td></td>
</tr>
<tr>
<td>(vii) Moulds used in rubber and plastic goods factories</td>
<td>30</td>
</tr>
<tr>
<td>(viii) Air pollution control equipment, being—</td>
<td>100</td>
</tr>
<tr>
<td>(a) Electrostatic precipitation systems</td>
<td></td>
</tr>
<tr>
<td>(b) Felt-filter systems</td>
<td></td>
</tr>
<tr>
<td>(c) Dust collector systems</td>
<td></td>
</tr>
<tr>
<td>(d) Scrubber-counter current/venturi/packed-bed/cyclonic scrubbers</td>
<td></td>
</tr>
<tr>
<td>(e) Ash handling system and evacuation system</td>
<td></td>
</tr>
<tr>
<td>(ix) Water pollution control equipment, being—</td>
<td>100</td>
</tr>
<tr>
<td>(a) Mechanical screen systems.</td>
<td></td>
</tr>
<tr>
<td>(b) Aerated detritus chambers (including air compressor)</td>
<td></td>
</tr>
<tr>
<td>(c) Mechanically skimmed oil and grease removal systems</td>
<td></td>
</tr>
<tr>
<td>(d) Chemical feed systems and flash mixing equipment</td>
<td></td>
</tr>
<tr>
<td>(e) Mechanical flocculators and mechanical reactors</td>
<td></td>
</tr>
<tr>
<td>(f) Diffused air/mechanically aerated activated sludge systems</td>
<td></td>
</tr>
<tr>
<td>(g) Aerated lagoon systems</td>
<td></td>
</tr>
<tr>
<td>(h) Biofilters</td>
<td></td>
</tr>
<tr>
<td>(i) Methane-recovery anaerobic digester systems</td>
<td></td>
</tr>
<tr>
<td>(j) Air floatation systems</td>
<td></td>
</tr>
<tr>
<td>(k) Air/steam stripping systems</td>
<td></td>
</tr>
<tr>
<td>(l) Urea Hydrolysis systems</td>
<td></td>
</tr>
<tr>
<td>(m) Marine outfall systems</td>
<td></td>
</tr>
<tr>
<td>(n) Centrifuge for dewatering sludge</td>
<td></td>
</tr>
<tr>
<td>(o) Rotating biological contractor or bio-disc</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>---</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td>(p)</td>
<td>Lon exchange resin column</td>
</tr>
<tr>
<td>(q)</td>
<td>Activated carbon column</td>
</tr>
<tr>
<td>(x)</td>
<td>(a) Solidwaste, control equipments being, caustic/lime/chrome/mineral/cryolite recovery system</td>
</tr>
<tr>
<td></td>
<td>(b) Solidwaste recycling and resource recovery systems</td>
</tr>
<tr>
<td>(xi)</td>
<td>Machinery and plant, used in semiconductor industry covering all integrated circuits (ICs) (excluding hybrid integrated circuits) ranging from small scale integration (SSI) to large scale integration/very large scale integration (LSI/VLSI) as also discrete semi-conductor devices such as diodes, transistors, thyristors, triacs, etc., other than those covered by entries (viii), (ix) and (x) of this sub-item and sub-item (8) below.</td>
</tr>
<tr>
<td>(xia)</td>
<td>Life saving medical equipment, being—</td>
</tr>
<tr>
<td></td>
<td>(a) D.C. Defibrillators for internal use and pace makers</td>
</tr>
<tr>
<td></td>
<td>(b) Haemodialysors</td>
</tr>
<tr>
<td></td>
<td>(c) Heart Lung Machine</td>
</tr>
<tr>
<td></td>
<td>(d) Cobalt Therapy Unit</td>
</tr>
<tr>
<td></td>
<td>(e) Colour Doppler</td>
</tr>
<tr>
<td></td>
<td>(f) SPECT Gamma Camera</td>
</tr>
<tr>
<td></td>
<td>(g) Vascular Angiography System including Digital subtraction Angiography</td>
</tr>
<tr>
<td></td>
<td>(h) Ventilator used with anaesthesia apparatus</td>
</tr>
<tr>
<td></td>
<td>(i) Magnetic Resonance Imaging System</td>
</tr>
<tr>
<td></td>
<td>(j) Surgical Laser</td>
</tr>
<tr>
<td></td>
<td>(k) Ventilators other than those used with anaesthesia</td>
</tr>
<tr>
<td></td>
<td>(l) Gamma knife</td>
</tr>
<tr>
<td></td>
<td>(m) Bone Marrow Transplant Equipment including silastic</td>
</tr>
<tr>
<td></td>
<td>Description</td>
</tr>
<tr>
<td>---</td>
<td>-------------</td>
</tr>
<tr>
<td>1</td>
<td>long standing intravenous catheters for chemotherapy</td>
</tr>
<tr>
<td>(n)</td>
<td>Fibre optic endoscopes including, Paediatric resectoscope/audit resectoscope, Peritoneoscopes, Arthroscope, Microlaryngoscope, Fibreoptic Flexible Nasal Pharyngo Bronchoscope, Fibreoptic Flexible Laryngo Brochoscope, Video Laryngo Brochoscope and Video Oesophago Gastroscope, Stroboscope, Fibreoptic Flexible Oesophago Gastroscope</td>
</tr>
<tr>
<td>(o)</td>
<td>Laparoscope (single incision)</td>
</tr>
<tr>
<td>4</td>
<td>Containers made of glass or plastic used as re-fills</td>
</tr>
<tr>
<td>5</td>
<td>Computers including computer software [see Note 7 below the Table]</td>
</tr>
<tr>
<td>6</td>
<td>Machinery and plant, used in weaving, processing and garment sector of textile industry, which is purchased under TUFS on or after the 1st day of April, 2001 but before the 1st day of April, 2004 and is put to use before the 1st day of April, 2004 [see Note 8 below the Table]</td>
</tr>
<tr>
<td>7</td>
<td>Machinery and plant, acquired and installed on or after the 1st day of September, 2002 in a water supply project or a water treatment system and which is put to use for the purpose of business of providing infrastructure facility under clause (i) of subsection (4) of section 80-IA [see Notes 4 and 9 below the Table]</td>
</tr>
<tr>
<td>8</td>
<td>(i) Wooden parts used in artificial silk manufacturing machinery</td>
</tr>
<tr>
<td></td>
<td>(ii) Cinematograph films – bulbs of studio lights</td>
</tr>
<tr>
<td></td>
<td>(iii) Match factories – wooden match frames</td>
</tr>
<tr>
<td>(iv) Mines and quarries:</td>
<td>100</td>
</tr>
<tr>
<td>------------------------</td>
<td>-----</td>
</tr>
<tr>
<td>(a) Tubs, winding ropes, haulage ropes and sand stowing pipes</td>
<td></td>
</tr>
<tr>
<td>(b) Safety lamps</td>
<td></td>
</tr>
<tr>
<td>(v) Salt works – Salt pans, reservoirs and condensers, etc., made of earthy, sandy or clayey material or any other similar material</td>
<td>100</td>
</tr>
<tr>
<td>(vi) Flour mills – Rollers</td>
<td>80</td>
</tr>
<tr>
<td>(vii) Iron and steel industry – Rolling mill rolls</td>
<td>80</td>
</tr>
<tr>
<td>(vi) Sugar works – Rollers</td>
<td>80</td>
</tr>
<tr>
<td>(ix) Energy saving devices, being—</td>
<td></td>
</tr>
<tr>
<td>A. Specialised boilers and furnaces:</td>
<td></td>
</tr>
<tr>
<td>(a) Ignifluid/ fluidized bed boilers</td>
<td></td>
</tr>
<tr>
<td>(b) Flameless furnaces and continuous pusher type furnaces</td>
<td></td>
</tr>
<tr>
<td>(c) Fluidized bed type heat treatment furnaces</td>
<td>80</td>
</tr>
<tr>
<td>(d) High efficiency boilers (thermal efficiency higher than 75 per cent in case of coal fired and 80 per cent in case of oil/ gas fired boilers)</td>
<td></td>
</tr>
<tr>
<td>B. Instrumentation and monitoring system for monitoring energy flows:</td>
<td></td>
</tr>
<tr>
<td>(a) Automatic electrical load monitoring systems</td>
<td></td>
</tr>
<tr>
<td>(b) Digital heat loss meters</td>
<td></td>
</tr>
<tr>
<td>(c) Micro-processor based control systems</td>
<td></td>
</tr>
<tr>
<td>(d) Infra-red thermography</td>
<td>80</td>
</tr>
<tr>
<td>(e) Meters for measuring heat losses, furnace oil flow, steam flow,</td>
<td></td>
</tr>
</tbody>
</table>
electric energy and power factor meters

(f) Maximum demand indicator and clamp on power meters

(g) Exhaust gases analyser

(h) Fuel oil pump test bench

C. Waste heat recovery equipment
   (a) Economisers and feeds water heaters
   (b) Recuperators and air pre-heaters
   (c) Heat pumps
   (d) Thermal energy wheel for high and low temperature waste heat recovery

D. Co-generation systems:
   (a) Back pressure pass out, controlled extraction, extraction-cum-condensing turbines for co-generation along with pressure boilers
   (b) Vapour absorption refrigeration systems
   (c) Organic rankine cycle power systems
   (d) Low inlet pressure small steam turbines

E. Electrical equipment:
   (a) Shunt capacitors and synchronous condenser systems
   (b) Automatic power cut off devices (relays) mounted on individual motors
(c) Automatic voltage controller

(d) Power factor controller for AC motors

(e) Solid state devices for controlling motor speeds

(f) Thermally energy-efficient stenters (which require 800 or less kilocalories of heat to evaporate one kilogram of water)

(g) Series compensation equipment

(h) Flexible AC Transmission (FACT) devices – Thyristor controlled series compensation equipment

(i) Time of Day (TOD) energy meters

(j) Equipment to establish transmission highways for National Power Grid to facilitate transfer of surplus power of one region to the deficient region

(k) Remote terminal units/intelligent electronic devices, computer hardware/software, router/bridges, other required equipment and associated communication systems for supervisory control and data acquisition systems, energy management systems
and distribution management systems for power transmission systems

(l) Special energy meters for Availability Based Tariff (ABT)

F. Burners:
(a) 0 to 10 per cent excess air burners
(b) Emulsion burners
(c) Burners using air with high pre-heat temperature (above 300oC)

G. Other equipment:
(a) Wet air oxidation equipment for recovery of chemicals and heat
(b) Mechanical vapour recompressors
(c) Thin film evaporators
(d) Automatic micro-processor based load demand controllers
(e) Coal based producer gas plants
(f) Fluid drives and fluid couplings
(g) Turbo charges/super-charges
(h) Sealed radiation sources for radiation processing plants

(x) Gas cylinders including valves and regulators 60
(xi) Glass manufacturing concerns – Direct fire glass melting furnaces 60
(xii) Mineral oil concerns:
(a) Plant used in field operations (above ground) distribution – Returnable packages 60
(b) Plant used in field operations (below ground), but not including kerbside pumps including under ground tanks and fittings used in field operations (distribution) by mineral oil concerns

(xiii) Renewable energy devices being:

(a) Flat plate solar collectors
(b) Concentrating and pipe type solar collectors
(c) Solar cookers
(d) Solar water heaters and systems
(e) Air/gas/liquid heating systems
(f) Solar crop drivers and systems
(g) Solar refrigeration, cold storages and air conditioning systems
(h) Solar steels and desalination systems
(i) Solar power generating systems
(j) Solar pumps based on solar-thermal and solar-photovoltaic conversion
(k) Solar-photovoltaic modules and panels for water pumping and other applications
(l) Wind mills and any specially designed devices which run on wind energy
(m) Any special devices including electric generators and pumps running on wind energy
(n) Biogas-plant and biogas-engines
(o) Electrically operated vehicles including battery powered or fuel-cell powered vehicles
(p) Agricultural and municipal waste conversion devices producing energy
(q) Equipment for utilising ocean waste and thermal energy
(r) Machinery and plant used in the manufacture of any of the above sub-items

(9) (i) Books owned by assessees carrying on a profession:
(a) Books, being annual publications
(b) Books, other than those covered by entry (a) above

(ii) Books owned by assessees carrying on business in running lending libraries

IV. SHIPS
(1) Ocean-going ships including dredgers, lugs, barges, survey launches and other similar ships used mainly for dredging purposes and fishing vessels with wooden hull
(2) Vessels ordinarily operating on inland waters, not covered by sub-item (3) below
(3) Vessels ordinarily operating on inland waters being speed boats [see Note 10 below the Table]

PART B
INTANGIBLE ASSETS
Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature

Notes:
1. "Buildings" include roads, bridges, culverts, wells and tubewells.
2. A building shall be deemed to be a building used mainly for residential purposes, if the built-up floor area thereof used for residential purposes is not less than sixty-six and two-third per cent of its total built-up floor area and shall include any such building in the factory premises.
3. In respect of any structure or work by way of renovation or improvement in or in relation to a building referred to in Explanation 1 of clause (ii) of sub-
section (1) of section 32, the percentage to be applied will be the percentage specified against sub-item (1) or (2) of item I as may be appropriate to the class of building in or in relation to which the renovation or improvement is effected. Where the structure is constructed or the work is done by way of extension of any such building, the percentage to be applied would be such percentage as would be appropriate, as if the structure or work constituted a separate building.

4. Water treatment system includes system for desalination, demineralisation and purification of water.

5. "Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.

6. "Commercial vehicle" means "heavy goods vehicle", "heavy passenger motor vehicle", "light motor vehicle", "medium goods vehicle" and "medium passenger motor vehicle" but does not include "maxi-cab", "motor-cab", "tractor" and "road-roller". The expressions "heavy goods vehicle", "heavy passenger motor vehicle", "light motor vehicle", "medium goods vehicle", "medium passenger motor vehicle", "maxi-cab", "motor-cab", "tractor" and "road-roller" shall have the meanings respectively as assigned to them in section 2 of the Motor Vehicles Act, 1988 (59 of 1988).

7. "Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device.


9. Machinery and plant includes pipes needed for delivery from the source of supply of raw water to the plant and from the plant to the storage facility.

10. "Speed boat" means a motor boat driven by a high speed internal combustion engine capable of propelling the boat at a speed exceeding 24 kilometers per hour in still water and so designed that when running at a speed, it will plane, i.e., its bow will rise from the water.

Test Your Knowledge

If a factory of an assessee is shifted to new site, the expenses of shifting the depreciable asset or its installation would form part of the actual cost. True or False

Correct answer: False

(D) Tea/Coffee/Rubber Development Account (Section 33AB)

With effect from the assessment year 1991-92, the substituted Section 33AB is applicable to an assessee carrying on the business of growing and manufacturing tea
in India. For claiming the deduction u/s 33AB the assessee has to satisfy the following conditions:

1. **Deposit of amount:**
   Where an assessee, carrying on business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of his income, whichever is earlier:
   
   (a) deposited with the National Bank any amount or amounts in an account (hereinafter in this section referred to as the special account) maintained by the assessee with the Bank in accordance with and for the purposes specified in a scheme (hereafter in this section referred to as the scheme) approved in this behalf by the Tea Board of India or the Coffee Board of India or the Rubber Board; or
   
   (b) Amount of Deduction:
   Deposited any amount in an account (hereafter in this section referred to as the Deposit Account) opened by the assessee in accordance with, and for the purposes specified in, a scheme framed by the Tea Board or the Coffee Board or the Rubber Board, as the case may be (hereafter in this section referred to as the deposit scheme) with the previous approval of the Central Government, the assessee, shall be allowed a deduction (before the loss, if any, brought forward from earlier years is set off under Section 72), of —
   
   (a) a sum equal to the amount or the aggregate of the amounts so deposited; or
   
   (b) Forty per cent of the profits of such business (computed under the head "Profits and gains of business or profession" before making any deduction under Section 33AB),
   
   whichever is less.

   However, where such assessee is a firm, any association of persons or body of individuals, deduction under this section shall not be allowed in the computation of the income of any partner, or member etc., of the firm/ AOP/BOI.

   Also, where any deduction, in respect of any amount deposited in the special account has been allowed in any previous year, no deduction shall be allowed in respect of any other previous year.

2. **Audit:**
   The deduction is admissible to only those assessees whose accounts have been audited and the assessee furnishes along with his return of income the report of such audit in the prescribed form and duly signed and verified by such accountant. In cases where the accounts of the tax payer are required to be audited under any other law, it would be sufficient if the accounts are audited under that law and the audit report as per that law is furnished with the return alongwith a further report in the form prescribed for the purposes of this provision.
(3) **Withdrawal of Amount:**

(a) There is a restriction on the withdrawal of the amount standing in the credit of such Special account of the assessee, i.e., the withdrawal must be made either: (i) for the purposes specified in the scheme, or, in the following circumstances: (a) closure of business; (b) death of an assessee; (c) partition of a H.U.F.; (d) dissolution of a firm; (e) liquidation of a company.

(b) Notwithstanding anything contained in (a) above, where any amount standing to the credit of the assessee in the special account or in the Deposit Account is released during any previous year by the National Bank or withdrawn by the assessee from the Deposit Account and such amount is utilised for the purchase of:

(a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest-house;

(b) any office appliances (not being computers);

(c) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head “Profits and gains of business or profession” of any one previous year;

(d) any new machinery or plant to be installed in an industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule,

the whole of such amount so utilized shall be deemed to be the profits and gains of business of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(4) **Consequences in case of closure of Business:**

In the event of withdrawal of any amount in the event of: (a) closure of business or; (b) dissolution of a firm, the whole of such amount shall be deemed to be the profits and gains of business or profession of that previous year and chargeable to income-tax as if the business had not closed, or, the firm not dissolved and taxable in that previous year.

(5) Conversely, where any amount standing to the credit of the assessee in the special account or in the Tea Deposit Account is utilised by the assessee for the purposes of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed as a revenue deduction in computing the income chargeable under the head “Profits and gains of business or profession”.

(6) Non-utilisation of any amount released by the National Bank, for being utilised by the assessee for the purposes of a business, in accordance with the scheme, renders the whole or part of the amount not utilised, as the case may be, deemed as profits and gains of business and, accordingly, chargeable to income-tax as income of that previous year. The exceptions to this provision are, when the amount is not utilised in the cases of: (i) death of
an assessee; (ii) partition of a Hindu undivided family; (iii) liquidation of a company.

(7) **Acquisition of Assets:**

In cases where the asset acquired in accordance with the scheme or deposit scheme is sold or otherwise transferred in any previous year by the assessee to any person, at any time before the expiry of eight years from the end of the previous year in which it was acquired, such part of the cost of the asset as is relatable to the deduction already allowed is deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and charged to income-tax accordingly.

But, these provisions do not apply where:

(i) the asset is sold or otherwise transferred by the assessee to Government, local authority, corporation established by or under a Central, State or Provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956; or

(ii) Where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm only where,

(i) all the properties of the firm relating to business or profession immediately before the succession become the properties of the company;

(ii) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and

(iii) all the shareholders of the company were partners of the firm immediately before the succession.

(a) “Coffee Board” means the Coffee Board constituted under Section 4 of the Coffee Act, 1942 (7 of 1942);

(aa) “National Bank” means the National Bank for Agriculture and Rural Development established under Section 3 of the National Bank for Agriculture and Rural Development Act, 1981 (61 of 1981);

(ab) “Rubber Board” means the Rubber Board constituted under Sub-section (1) of Section 4 of the Rubber Board Act, 1947 (24 of 1947);

(b) “Tea Board” means the Tea Board established under Section 4 of the Tea Act, 1953 (29 of 1953).

(E) **Site restoration fund [Section 33ABA]**

An assessee can claim deduction under Section 33ABA, with effect from the assessment year 1999-2000, if certain conditions are satisfied:

The assessee must satisfy the following conditions:
1. **Production of petroleum or natural gas:** The taxpayer is engaged in the business of the prospecting for, or extraction or production of, petroleum or natural gas or both in India.

2. **Agreement:** The Central Government has entered into an agreement with the taxpayer for such business.

3. **Deposit:**
   (a) deposit with SBI any amount in an account (hereinafter referred to as special account) maintained by the assessee with that bank in accordance with and for the purpose specified in, a scheme approved by the Government of India in the Ministry of Petroleum and Natural Gas; or
   (b) deposit any amount in an account (hereinafter referred to as site restoration account) opened by the assessee in accordance with, and for the purposes specified in, a scheme framed by the Ministry of Petroleum and Natural Gas (hereinafter referred to deposit scheme).
   The aforesaid amount shall be deposited before the end of the previous year.

4. **Audit:**
   The accounts of the taxpayer should be audited by an accountant as defined in the Explanation below Sub-section (2) of Section 288 and the report of the auditor is filed along with the return of the relevant assessment year.
   Provided that, in case where the accounts of the taxpayer are required to be audited under any other law, e.g. under the Companies Act, it would be sufficient if the accounts are audited under that law and the audit report as per that law is furnished with the return along with a further report in the form prescribed for the purposes of the provision.

5. **Amount of deduction:**
   (a) a sum equal to amounts deposited as mentioned in Point No. 2 above; or
   (b) 20 per cent of the profit of such business computed under the head “Profits and gains of business or profession” before making any deduction under Section 33ABA and before adjusting brought forward business loss under Section 72, whichever is less.

   However:
   1. Where any deduction is claimed under this section, no deduction shall be allowed in respect of such amount in any other previous year.
   2. Where a deduction is claimed and allowed under this section, to a firm, association of persons or body of individuals, no deduction shall be allowed to any partner of the firm or the member of the association or body in respect of the same deposit.

   The amount standing to the credit of such special account or site restoration account may be withdrawn only for the purpose specified in the scheme or deposit scheme. If the amount released by SBI or the amount withdrawn from site restoration account in a year is not utilized in the same previous year for the purpose for which it
is released, the amount not so utilized will be treated as taxable profits of that year and taxed accordingly.

Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account as reduced by the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in Section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year. Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee is no longer in existence, the above provisions shall apply as if the business is in existence in that previous year.

There is an overriding condition that the deduction under this provision cannot be claimed in relation to amounts utilized for the purpose of any machinery or plant to be installed in any office premises or residential accommodation including guest house; any office appliance, other than computers; any other plant or machinery which either is installed in an undertaking producing low priority items specified in the Eleventh Schedule in the Act or is an item of plant or machinery entitled to 100 per cent write off by way of depreciation or for any other reason in any one year.

The deduction allowed under this provision will be withdrawn if the asset acquired in accordance with the scheme is sold or otherwise transferred within 8 years from the end of the previous year in which it is acquired. For this purpose, the cost of the asset relatable to the deduction allowed will be treated as taxable business profits of the year in which the asset is sold or otherwise transferred.

The deduction allowed earlier will, however, not be withdrawn in cases where the asset is transferred within 8 years period to Government, local authority statutory corporation or Government company.

It will also not be withdrawn where the transfer takes place in a connection with succession of a firm by a company. For this purpose it is necessary that:

(a) the scheme continues to apply to the company in the manner applicable to the firm;

(b) the successor company takes over all the assets and liabilities of the firm; and

(c) all the shareholders of the company were partners of the firm before the succession.

(F) Reserves for Shipping Business (Section 33AC)

No deduction under this section shall be allowed under this section for any assessment year commencing on or after 1st day of April, 2005 i.e from assessment year 2005-06.

(G) Expenditure on Scientific Research (Section 35)

The term "scientific research" means any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry
or fisheries. With a view to accelerating scientific research, Section 35 of the Act provides tax incentives.

**1) Revenue expenditure incurred by an assessee**

(i) **Assessee himself carries on scientific research [Section 35(1)(i)]**

Where the assessee himself carries on scientific research and incurs revenue expenditure, deduction is allowed for such expenditure only if the research relates to his business.

**Pre-commencement period expenses:**

Further, revenue expenditure incurred by an assessee on payment of salary to research personnel and on material inputs during the period of 3 years immediately preceding the commencement of the business is regarded as having been laid out or expended in the previous year in which the business is commenced only salary is allowed if it is incurred for 3 years immediately preceding the previous year. Such expenditure incurred in the period before commencement of business is, therefore, allowed as deduction in computing assessee's income of the year in which the business is commenced. The deduction is available only in respect of expenditure incurred after March 31, 1973 on scientific research related to the assessee's business. In order to prevent misuse of the concession, deduction is limited to an amount certified by the prescribed authority. Prescribed authority as per rule 6 is Director General (Income-tax Exemptions) in concurrence with the Secretary, Department of Scientific and Industrial Research, Government of India. The 'salary' allowable for this purpose includes wages, annuity, pension or gratuity, fees or commission, profits in lieu of or in addition to any salary or wages, advance of salary and annual accretion to the balance at the credit of the employee participating in a recognised provident fund to the extent to which it is chargeable to tax under rule 6 of Part A of the Fourth Schedule. It may be mentioned that expenditure incurred on the provision of "perquisites" before commencement of business is not allowed as deduction. In other words, expenditure incurred by the assessee on providing different perquisites (such as concessional residential accommodation, or any benefit or amenity provided free of cost or at a concessional rate etc.) to research personnel before commencement of business is not allowable as deduction.

(ii) **Contribution made to outsiders [Section 35(1)(ii) & (iii)]:**

Where the assessee does not himself carry on scientific research but makes contributions to other institutions for this purposes deduction is allowed, if:

(a) the payment is made to an approved research association which has, as its object, undertaking of research related or unrelated to the business of assessee, a deduction of 175% of expenditure incurred is allowed.[Section 35(1)(iii)];

(b) the payment is made to an approved university, college or institution to be used for scientific research related or unrelated to the business of assessee [Section 35(1)(ii)], deduction shall be allowed to the extent of 175% of the actual expenditure.

(c) the payment is made to an approved company to be used by it for scientific
research, deduction shall be allowed to the extent of 125% of the sum paid provided such company;
(i) is registered in India,
(ii) has as its main object the scientific research and development,
(iii) is, for the purposes of this clause, for the time being approved by the prescribed authority in the prescribed manner, and
(iv) fulfills such other conditions as may be prescribed.

A deduction of 125% of the sum paid shall be allowed as deduction. [Section 35(1)(iia)]

d) the payment is made to a research association which has its object the undertaking of research in social science or statistical research or to a university, college or institution for the use of research in social sciences or statistical research, related or unrelated to the business of the assessee provided such university, college or institution is, for the time being, approved by the Central Government by notification in the Official Gazette [Section 35(1)(iii)], deduction shall be allowed to the extent of 125% of the sum paid.

The approval to research association, university, college or institution mentioned above is required to be obtained from the Central Government as provided by Finance Act, 1999 w.e.f. 1.4.2000.

The deduction available for such payments mentioned in clauses (a), (b) and (c) above to the extent of one and one-fourth times of any sum paid; with effect from Assessment Year 2000-01.

(2) Capital expenditure on scientific research:

(i) Incurred by the assessee himself: Expenditure of a capital nature on scientific research related to the business carried on by the assessee is also allowable to the following extent:

(a) Where the capital expenditure is incurred after March 31, 1967, the whole of the capital expenditure incurred in any previous year is deductible for that previous year. However, expenditure incurred on the acquisition of any land, whether acquired as such or part of any property, after 29.2.1984, is not deductible.

(b) Capital expenditure incurred before the commencement of the business is deemed to have been incurred in the previous year in which the business is commenced, to the extent of the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business.

Where an asset representing expenditure of a capital nature incurred before 1.4.1967, ceases to be used in a previous year for scientific research related to the business and the value of the asset at the time of the cessation, together with the aggregate of deductions already allowed falls short of the said expenditure then - (i) the deficiency is allowable as a deduction for the relevant previous year. Thereafter, no further deduction is allowable for any subsequent previous year.

Also in the case of sale of such assets, without use thereof for other purposes, in the year of cessation, the sale price shall be taken to be the value of the asset at the
time of cessation and if the asset is sold without having been used for other purposes, in a previous year subsequent to the year of cessation and the sale price falls short of the value of the asset taken into account at the time of cessation, the deficiency shall be allowed as a deduction for the previous year in which the sale took place.

Deduction by way of depreciation is not admissible in respect of an asset used in scientific research either in the year in which the capital expenditure is incurred or in a subsequent year. However, in the event of use of such assets for business, after cessation of use thereof for scientific research related to that business, the same asset shall become entitled to depreciation.

(ii) Carry forward and set off of deficiency in subsequent years:

If on account of inadequacy or absence of profits of the business, deduction on account of capital expenditure referred to in Section 35(1)(iv) of the Act cannot be allowed, fully or partly, the deficiency so arising is to be carried forward for 8 years and set off in any subsequent assessment year. However, carry forward of deficiency is subject to the condition that business loss already brought forward, if any, will have precedence over such deficiency in the matter of set off. To put it little differently, the aforesaid deficiency will be given the same treatment as is given to unabsorbed depreciation vis-a-vis brought forward business losses.

(iii) Consequences in case of amalgamation:

In pursuance of an agreement of amalgamation, if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provisions of Section 35 would apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the asset.

To avail the benefit of this section, the following procedures have also to be complied with:

— The research association, university, college or other institution makes an application in the prescribed form and manner to the Central Government for grant of approval or continuance of the scientific research.

— Before grant of the approval so sought, the Central Government may call for such documents including audited annual accounts or information from the research association, university, college, or other institution as it thinks necessary to satisfy itself about the genuineness of the activities of the research association, university, college or other institution. The prescribed authority is also empowered to make such inquiries as it may deem necessary, in this behalf, and

— The notification issued by the Central Government shall have effect for such assessment year or years, up to a maximum of three assessment years, including the assessment year or years commencing before the date on which the notification is issued, as may be specified in the notification.

Any question as to what extent an activity constitutes scientific research or any asset was being used for scientific research, if arises it will be referred to the
prescribed authority and its decision shall be final.

However, any such question relating to any activity of research association or university, college or other institution for which weighted deduction of one and one-fourth times the payment amount is given and for which approval from Central Government is required to be obtained, the question is also required to be referred to Central Government only and not to prescribed authority.

(3) Contribution to National Laboratory [section 35(2AA)]:

Where any sum is paid to a National Laboratory, approved for this purpose by the Indian Council of Agricultural Research or the Indian Council of Medical Research or the Council of Scientific and Industrial Research etc., or to any University, or to Indian Institute of Technology, a weighted deduction of 200% (substituted by Finance Act, 2011 earlier it was 175%) of the sum paid shall be allowed as deduction under Section 35(2AA) of the Act.

(4) Expenditure on in-house research and development expenses [Section 35(2AB)]:

Where a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal to 200% of the expenditure so incurred.

(I) Expenditure on Acquisition of Patent Rights or Copyrights (Section 35A)

Capital expenditure incurred by all assessees at any time after 28.2.1966 but before 1st April, 1998 for the purpose of acquisition of patent rights or copyrights for the purposes of his business, would be allowed to be amortised over a period of 14 years in equal instalments beginning with the previous year in which such expenditure is incurred or where such expenditure is incurred before the commencement of the business, the fourteen previous years would be calculated from the previous year in which the business commenced. With effect from 1.4.98 depreciation on intangible assets has been introduced. It is charged @25%. In view of this change expenditure under this section need not be amortised if incurred after the given date. However, where the rights became effective in a year prior to the one in which the expenditure is incurred, the deduction would be allowable to the assessee in respect of that period as remains unexpired. In other words, if at the time of acquisition (incurred the expenses) of the patent, say, the patent has already been utilized for 10 years by the assessee, the cost of the patent would be allowed as a deduction in four equal instalments in the remaining four years. In cases where the assessee acquires the patent or copyright at a time when only one year of its life remains, the entire cost of the patent to the assessee would be allowed in the year of acquisition itself. The other provisions relating to the allowance of deduction in respect of capital expenditure incurred for acquiring patents or copyrights are as under:

(i) Where a part of the right is sold and the proceeds of the sale are not less
than the cost of acquisition thereof remaining unallowed, no deduction shall be allowed in respect of the previous year in which a part is so sold and in respect of any subsequent previous year.

(ii) Where the rights either come to an end or are sold in their entirety and the proceeds of sale are less than the cost of acquisition thereof remaining unallowed, a deduction equal to such cost remaining unallowed or as the case may be such cost remaining unallowed, as reduced by the proceeds of the sale, shall be allowed in the year in which rights come to an end or are sold.

(iii) Where the whole or any part of the rights is sold at a profit, the profits shall be chargeable as balancing charge. In case of the sale of the rights in the year in which the business is no longer in existence, the profits shall be chargeable as if the business is in existence in that previous year.

(iv) Where a part of the rights is sold and (iii) above does not apply the amount of deduction for that year and the subsequent year shall be calculated as follows:

(a) subtract the proceeds of sale from the cost of acquisition of the rights remaining unallowed; and

(b) divide the remainder by the number of previous year which have not expired at the beginning of the year in which the rights are sold.

(v) In case of amalgamation of companies, the amalgamated company (being an Indian company) is entitled to continuation of benefits in the same way as amalgamating company would have enjoyed, if it has not so sold or otherwise transferred the rights.

Similarly, in case of demerger of companies, the resulting company (being an Indian company) is entitled to continuation of benefits in the same way as demerged company would have enjoyed, if it had not so sold or otherwise transferred the rights.

(I) Deduction in respect of expenditure on know-how (Section 35AB)

Any lump sum consideration paid by the assessee in any previous year relevant to the assessment year commencing on or before 1st April, 1998 for acquiring any know-how for use for the purpose of his business will be allowed as deduction by spreading it equally over six years, namely, the year in which the lump sum consideration is paid and the five immediately succeeding years. With effect from 1.4.98 depreciation on intangible assets has been introduced and charged @25%. In view of this change expenditure under this section is not to be amortised if incurred after the given date. Where the know-how is developed in a laboratory, University or institution etc., the consideration shall be spread equally over 3 years. In case of transfer of business under the scheme of amalgamation or demerger where amalgamating or the demerged company is entitled to a deduction under this section, then the amalgamated company or the resulting company, as the case may be shall be entitled to claim deduction under this sub-section for the residual period as if the business or the undertaking had continued. For the purpose of this section -know-how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral
deposits (including searching for, discovery or testing of deposits or winning of access thereto).

Now a days no deduction is available under section 35AB.

(J) Expenditure on telecom licence (Section 35ABB)

Where any capital expenditure is incurred by the assessee for acquiring any right to operate telecommunications services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal instalments over the period for which the licence remains in force, subject to the following:

(a) If the fee is paid for acquiring any right to operate telecommunications services before the commencement of such business, the deduction shall be allowed for the previous years beginning with the previous year in which such business is commenced.

(b) If the fee is paid for acquiring such rights after the commencement of such business the deduction shall be allowed for the previous years beginning with the previous year in which the license fee is actually paid (irrespective of the previous year in which the liability for the expenditure is incurred).

Profit/loss on Sale -

1. Where the licence is transferred and proceeds of transfer (sale proceeds) are less than the amount of expenditure incurred remaining unallowed:

   (i) Where whole of the licence is transferred in a previous year. Deduction as given below shall be allowed in the previous year in which the licence is transferred.

      Expenditure remaining unallowed less sale proceeds.

   (ii) Where part of the licence is transferred in a previous year. Deduction as given below shall be allowed in the balance number of relevant previous years.

      (expenditure remaining unallowed less sale proceeds) divided by balance number of relevant previous years, i.e., the previous years not expired at the beginning of the year of transfer.

2. Where the licence is transferred and the proceeds of transfer (sale proceeds) exceed the amount of expenditure incurred remaining unallowed.

   Sale proceeds less expenditure remaining unallowed subject to deductions already allowed shall be chargeable to income tax as profits and gains of the business in the previous year in which licence is transferred. Consequently, no further deduction in the previous year in which licence is transferred or in any subsequent previous years is allowed.

   Where licence is transferred in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

   Where under a scheme of amalgamation a telecom licence is transferred by the amalgamating company to the amalgamated company (being an Indian company),
then deduction will not be available under this section to the amalgamating company, instead the provisions of this Section (35ABB) will continue to apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

Similarly in a scheme of demerger a telecom licence is transferred by the demerged company to the resulting company, then deduction will not be available to the demerged company and will instead apply to the resulting company as they would have applied to the demerged company if the latter had not transferred the licence.

Further where a deduction for any previous year is claimed and allowed under Section 35ABB, then no deduction under Section 32(1) shall be allowed for the same or any subsequent previous year.

(K) Expenditure on Eligible projects or schemes (Section 35AC)

Section 35AC has been inserted by Finance (No. 2) Act, 1991 from the assessment year 1992-93 onwards. Under this section an assessee is allowed a deduction in computing profits of business or profession in respect of any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme.

For this purpose "eligible project or scheme" means such project or scheme for promoting the social and economic welfare of, or the upliftment of the public as the Central Government may on the recommendations of the National Committee notify in the Official Gazette.

National Committee for this purpose will be the Committee constituted by the Central Government, from amongst the persons of eminence in public life.

In addition to the aforesaid mode of payment a company can claim deduction by expending directly on the eligible project or scheme.

In order to claim deduction the assessee has to furnish along with his return of income a certificate—
(a) from the public sector company, or local authority or as the case may be association or institution where the payment is made through these bodies.
(b) in any other case (like payment made directly by a company on the eligible projects in scheme) from a Chartered Accountant.

in such manner, form and containing such particulars as may be prescribed.

Further, a deduction under this section if, is claimed and allowed for any assessment year, disentitles the assessee from claiming deduction in respect of such expenditure under any other provision of this Act for the same or any other assessment year.]

(L) Expenditure of capital nature incurred in respect of specified business (Section 35AD)

(1) An assessee shall be allowed a deduction of capital nature expenditure
incurred for any specified business carried on by him during the previous year in which such expenditure is incurred by him.

(2) This section applies to the specified business which fulfils all the following conditions:

(i) it is not set up by splitting up, or the reconstruction, of a business already in existence;

(ii) it is not set up by the transfer to the specified business of machinery or plant previously used for any purpose;

(iii) where the business is of the nature referred to in sub-clause (iii) of clause (c) of subsection (8), such business,

(a) is owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;

(b) has been approved by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 and notified by the Central Government in the Official Gazette in this behalf;

(c) has made not less than such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 available for use on common carrier basis by any person other than the assessee or an associated person; and

(d) fulfils any other condition as may be prescribed.

(3) The assessee shall not be allowed any deduction under Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" in relation to such specified business for the same or any other assessment year where a deduction under this section is claimed and allowed.

(4) No deduction in respect of the expenditure referred to in sub-section (1) shall be allowed to the assessee under any other section in any previous year or under this section in any other previous year.

(5) The provisions of this section shall apply to the specified business referred to in sub-section (2) if it commences its operations,

(a) on or after the 1st day of April, 2007, where the specified business is in the nature of laying and operating a cross-country natural gas pipeline network for distribution, including storage facilities being an integral part of such network;

(aa) on or after the 1st day of April, 2010, where the specified business is in the nature of building and operating a new hotel of two-star or above category as classified by the Central Government; and

(ab) on or after the 1st day of April, 2010, where the specified business is in the
nature of building and operating a new hospital with at least one hundred beds for patients;

(ac) on or after the 1st day of April, 2010, where the specified business is in the nature of developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and which is notified by the Board in the behalf in accordance with guidelines as may be prescribed.

(ad) on or after the 1st day of April, 2011, where the specified business is in the nature of developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;

(ae) on or after the 1st day of April, 2011, in a new plant or in a newly installed capacity in an existing plant for production of fertilizer; and

(b) on or after the 1st day of April, 2009, in all other cases not falling under clause (a), clause (aa), clause (ab), clause (ac), clause (ad) and clause (ae).

(6) The assessee carrying on the business of the nature referred to in clause (a) of sub-section (5) shall be allowed, in addition to deduction under sub-section (1), a further deduction in the previous year relevant to the assessment year beginning on the 1st day of April, 2010, of an amount in respect of expenditure of capital nature incurred during any earlier previous year, if

(a) the business referred to in clause (a) of sub-section (5) has commenced its operation at any time during the period beginning on or after the 1st day of April, 2007 and ending on the 31st day of March, 2009; and

(b) no deduction for such amount has been allowed or is allowable to the assessee in any earlier previous year.

(7) The provisions contained in sub-section (6) of section 80A and the provisions of sub-sections (7) and (10) of section 80-IA shall, so far as may be, apply to this section in respect of goods or services or assets held for the purposes of the specified business.

(8) For the purposes of this section,

(a) an "associated person", in relation to the assessee, means a person,

(i) who participates, directly or indirectly, or through one or more intermediaries in the management or control or capital of the assessee;

(ii) who holds, directly or indirectly, shares carrying not less than twenty-six per cent. of the voting power in the capital of the assessee;

(iii) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or

(iv) who guarantees not less than ten per cent. of the total borrowings of the assessee;

(b) "cold chain facility" means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and
processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce;

(c) "specified business" means the any one or more of the following business, namely

(i) setting up and operating a cold chain facility;

(ii) setting up and operating a warehousing facility for storage of agricultural produce;

(iii) laying and operating a cross-country natural gas or crude or petroleum oil pipeline

(iv) building and operating, anywhere in India, a hotel of two-star or above category as classified by the Central Government.

(v) Building and operating anywhere in India, a hospital with at least one hundred beds for patients;

(vi) developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and which is notified by the Board in the behalf in accordance with guidelines as may be prescribed.

(vii) developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;

(viii) production of fertilizer in India;

(d) any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if

(i) such machinery or plant was not, at any time prior to the date of the installation by the assessee, used in India;

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

(iii) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee;

(e) where in the case of a specified business, any machinery or plant or any part thereof previously used for any purpose is transferred to the specified business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent. of the total value of the machinery or plant used in such business, then, for the purposes of clause (ii) of sub-section (2), the condition specified therein shall be deemed to have been complied with;

(f) any expenditure of capital nature shall not include any expenditure incurred on the acquisition of any land or goodwill or financial instrument.
(M) Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes (Section 35CCA)

Any sum paid to a rural development fund set up and notified by the Central Government and to the National Urban Poverty Eradication Fund similarly set up and notified qualifies for deduction.

(N) Expenditure by way of Payment to Associations and Institutions for carrying out Programmes of Conservation of Natural Resources (Section 35CCB)

Sums paid on or before 31.3.2002 by an assessee carrying on business or profession to an approved association or institution which has as its object the undertaking of any programme of conservation of Natural resources (or of afforestation w.e.f. the assessment year 1991-92) to be used for such programme, are allowed a deduction of the amount of such expenditure incurred during the previous year. The deduction under this provision is not allowed unless the association or institution is for the time being approved by the prescribed authority. As per Rule 6AAC, the prescribed authority for this purpose is Secretary, Department of Environment, Government of India. Further, the prescribed authority shall not grant such approval for more than three years at a time.

Also, where an assessee carrying on business or profession incurs any expenditure by way of payment of any sum to any fund for afforestation as notified by Central Government, such sum is allowed as a deduction (in the previous year) in computing taxable profits.

(O) Amortisation of Preliminary Expenses (Section 35D)

Under Section 35D, Indian companies and other non-corporate taxpayers resident in India would be entitled to amortisation of certain preliminary expenses incurred by them at any time after 31.3.1970.

The expenditure which qualifies for amortisation should have been incurred by the assessee: (i) before the commencement of his business, (ii) if however, the expenditure is incurred after the commencement of business, it is essential that the expenditure should be in connection with the extension or expansion of the undertaking of the assessee or in connection with the setting up of a new unit by the assessee.

Amount of Deduction:

The amount qualifying for amortisation would be allowable as a deduction in five equal instalments beginning with the previous year in which the business of the assessee actually commences or the previous year in which the extension of the present undertaking is completed or the new unit commences production or operation, as the case may be.

Qualifying amount of expenses:

The following items of expenses qualify for amortisation under this section as preliminary expenses:
(i) expenditure incurred by the assessee in connection with the preparation of feasibility report or project report;
(ii) expenses for conducting market survey or any other survey necessary for the purpose of the business of the assessee;
(iii) expenditure for getting engineering services related to the business of the assessee;
(iv) expenses by way of legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;
(v) in the case of a company
   (a) expenses by way of legal charges for drafting the Memorandum and Articles of Association of the Company;
   (b) expenses for printing the Memorandum and Articles of Association;
   (c) expenses by way of fees for registration of the company under Companies Act, and
   (d) expenditure incurred in connection with issue for public subscription of shares or debentures of the company, being underwriting commission, brokerage and the charges of drafting, typing, printing and advertisement of the prospectus; and
(vi) such other items of expenses not covered by the list specified above which the Central Board of Direct Taxes may prescribe for the purpose of amortisation under this section.

Amount qualifying for deduction:

The maximum amount allowable as preliminary expenses qualifying for amortisation should be restricted to an amount calculated at 5% of (a) the cost of the project, or (b) where the assessee is an Indian Company, at the option of the company, of the capital employed in the business of the company or cost of project.

For the purpose of amortisation, the expression “Cost of the Project” in relation to the expenses incurred before the commencement of the business means the actual cost of the fixed assets being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of land and buildings, which are shown in the books of accounts of the assessee as on the last day of the accounting year in which the business of the assessee actually commences. Where the expenses are incurred after the commencement of business either in connection with the extension of the present undertaking or in connection with the setting up of a new unit, the cost of the project should be taken to mean the actual cost of the fixed assets, being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of the land and building which are shown in the books of the assessee as on the last day of the previous year in which extension of the undertaking is completed or the new unit commences production or operations, as the case may be, to the extent to which such fixed assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit of the assessee.

In the case of company, the capital employed in the business means where
preliminary expenses have been incurred before the commencement of the business, the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the accounting year in which the business of the company has actually commenced. In cases where the expenditure has been incurred after the commencement of the business, the capital employed in the business of the company should be taken to be the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the accounting year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, to the extent to which the capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or setting up of the new unit of the company.

For the purpose of amortisation of preliminary expenses: the expression „long-term borrowings“ to be included as part of the capital employed in the business of the company should be taken to mean:

(i) any moneys borrowed by the company from the Government or the Industrial Finance Corporation of India or Industrial Credit and Investment Corporation of India or any other financial institution which is eligible for deduction under Section 36(1)(vii) of the Act or any banking institution; or

(ii) any moneys borrowed or debt incurred by the company in a foreign country in respect of the purchases outside India of capital plant and machinery where the terms of the borrowing provide for repayment of the money borrowed or debt incurred over a period of not less than seven years.

In cases where the assessee qualifying for allowance of preliminary expenses is a person other than a company or a co-operative society, the allowance towards amortisation of preliminary expenses is subject to the condition that the accounts of the assessee for the year or years in which the preliminary expenses are incurred have been audited by a Chartered Accountant or other accountant specified in Section 228(2) of the Act and, in addition, the assessee furnishes along with his return of income for the first year in which the deduction is claimed the report of audit in the prescribed form, duly signed and verified by the auditor and setting out such other particulars as have been prescribed by the Board for this purpose.

In cases of amalgamation as defined in Section 2(1B) of the Act, the amalgamating company would not be entitled to the allowance towards amortisation of preliminary expenses in the year in which the amalgamation takes places. But the amalgamated company would be entitled to the allowance for the remaining period over which the allowance under this section is available. The total period over which the amortisation is allowable should not exceed ten years or five years as the case may be in the case of both the amalgamating company and the amalgamated company. The allowance under this section would not be denied, in cases of amalgamation, to the amalgamated company merely because the expenditure has not actually been incurred by the amalgamated company. Similarly, in case of demerger where an undertaking of an Indian company which is entitled to the deduction under this section is transferred before the expiry of the said period of 10 years or 5 years (as the case may be), to another company in a scheme of demerger no deduction shall be admissible to the demerged company in the year in which the demerger takes place. The resulting company would be entitled to claim deduction for
the balance period under this section. In other words, the deduction for the balance period will be available to resulting company as it would have been available to demerged company, if the demerger had not taken place. In cases where preliminary expenses qualify for amortisation under Section 35D and the allowance claimed by the assessee in this regard is allowed in any assessment year, these expense would not qualify for any allowance or deduction in respect of any other assessment year or even in the same year under any other provision of the Income-tax Act, 1961.

(P) Amortisation of Expenditure in the case of Amalgamation/Demerger (Section 35DD)

The section provides that where an assessee, being an Indian company, incurs expenditure on or after April 1, 1999 wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall be allowed a deduction equal to one fifth of such expenditure for five successive previous years beginning with the previous year in which amalgamation or demerger takes place. No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

(Q) Amortisation of Expenditure in the case of Voluntary Retirement Scheme (Section 35DDA)

The object of this section is to provide amortisation of one-fifth every year from the year in which the expenditure is incurred, of expenditure by way of payment of any sum to an employee in connection with his voluntary retirement. It also provides that no deduction would be allowed in respect of such expenditure under any other provision of the Act.

This provision supersedes the view expressed by the CBDT in its circular dated January 23, 2001, that the expenditure has to be treated as capital expenditure with the result that no allowance would be permissible in regard to this expenditure.

(R) Deduction in respect of Expenditure on Prospecting etc. for certain Minerals (Section 35E)

Section 35E of the Income-tax Act provides allowance to amortise the capital expenditure incurred by an assessee towards prospecting for certain minerals. The benefit of amortisation under this section is available to Indian companies and other non-corporate entities resident in India.

The expenditure qualifying for amortisation would cover expenses incurred by the assessee after 31-3-1970 in relation to the operations towards prospecting for, or extraction or production of any of the 27 minerals or 16 groups of associated minerals specified in the Seventh Schedule to the Income-tax Act. The expenditure incurred by the assessee would qualify for amortisation only if the expenditure in question is incurred by the assessee during the year of commercial production and/or in one or more of the four years immediately preceding that year; in any case the expenditure must have been incurred after 31-3-1970 wholly and exclusively on any of the operations relating to the prospecting for any mineral or group of associated minerals or on the development of a mine or other natural deposit of any such mineral or group of associated minerals. However, any portion of the expenditure which is met directly or indirectly by any other person or authority and sale, salvage, compensation or
insurance moneys realised by the assessee in respect of any property or right brought into existence as a result of the expenditure should be excluded from the amount of expenses qualifying for amortisation under this section.

The assessee would not be entitled for amortisation under this section in respect of the following three items of expenses namely,

(i) Expenditure incurred on the acquisition of the site of the source of any mineral or group of associated minerals or of any right in or over such site.

(ii) Expenditure on the acquisition of the deposits of such minerals or group of associated minerals or of any right in or over such deposits; or

(iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is available under Section 32 of the Income-tax Act.

The amortisation is granted to the assessee over a period of ten years reckoned from the year of commercial production by way of a deduction of an amount equal to 10% of the expenditure qualifying for amortisation every year (known as the instalment). There may be cases where the profits of the assessee derived from the commercial exploitation of any mine or other natural deposit of the mineral or any one or more of the minerals in a group of associated minerals in respect of which the expenditure was incurred, may be insufficient to allow deduction of the amount of instalment allowable to the assessee either in full or in part. In such cases, the deduction in any accounting year must be restricted to a sum equal to the actual income derived from the commercial exploitation of the mines, etc., so that as a result of the allowance of the instalment, the net result is not a negative figure. The amount of instalment in any particular year, to the extent to which it is not fully allowed as a deduction on account of insufficiency of profits, would be carried forward separately by the assessee for being set off or adjusted against the profits of the subsequent years arising from the commercial exploitation of the mine. Thus, the amount of instalment brought forward from an earlier accounting year is deemed to be a part of the instalment allowable in respect of the subsequent year together with the amount of instalment normally allowable for that year. The assessee's right to carry forward the unabsorbed portion of instalment(s) would not, however, be available beyond a period of ten accounting years as calculated from the year of commercial production. The distinction between the amortisation of preliminary expenses and the amortisation of expenses in regard to prospecting etc. for mines is that in the former case the amount of deduction allowable would in the event of insufficiency of profits, form part of the business loss for the assessee of the relevant year and would consequently qualify for being carried forward as business loss for the subsequent eight years to be set off against business income, in the latter case, the deduction in respect of mining expenses would not qualify for allowance against income under any other head or even against income from any business other than the mines. The assessee's right to carry forward the unabsorbed portion of the mining expenses gets automatically lapsed at the expiry of ten years from the year of commercial production whereas in the case of preliminary expenses even in the tenth year the deduction allowable to the assessee could be allowed and in the event of inadequacy of profits, could be carried forward as part of business loss.

For the purpose of amortisation under Section 35E, the expression “operation
relating prospecting” means any operation undertaken for the purpose of exploring, locating or proving deposits of any mineral and includes any such operation which proves to be infructuous or abortive.

The expression “year of commercial production” refers to the accounting year in which, as a result of any operation relating to prospecting, the commercial production of any mineral or any one or more of the minerals in a group of associated minerals specified in Part A or Part B respectively, of the Seventh Schedule actually commences.

In cases where a deduction is claimed by the assessee under Section 35E and allowed to him as a deduction in any assessment year in respect of the expenditure qualifying for amortisation, the assessee is not entitled to claim deduction in respect of the same expenditure in the same or another assessment year under any other provisions of the Income-tax Act.

In case of amalgamation, the amalgamating company would not be entitled to the allowance under Section 35E for the accounting year in which the amalgamation takes place as, from the year of amalgamation, the allowance would be granted to the amalgamated company in the same way and to the extent as it would have been granted in the case of amalgamating company if the amalgamation had not taken place. The total period for which the allowance is granted should not exceed ten years in the case of the amalgamating and the amalgamated company taken together. Similarly, in case of demerger, the demerged company would not be entitled to the allowance under Section 35E for the accounting year in which demerger takes place. From the year of demerger, the deduction would be granted to the resulting company as it would have been available to the demerged company, if the demerger had not taken place for the balance number of years out of ten years, i.e. the total period for which deduction is granted should not exceed ten years in the case of demerged company and resulting company taken together. Where the assessee is a person other than a company or a cooperative society, the deduction under the section is allowable only if the accounts of the assessee for the year of commercial production and for the immediately preceding four years in which the expenditure qualifying for amortisation is actually incurred, have been audited by a Chartered Accountant. The assessee must furnish along with his return of income, for the first year in which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditor setting forth such other particulars as may be prescribed for this purpose.

(S) Other Deductions

In addition to the various items of expenses and allowances provided by Sections 30 to 35E, Section 36 grants deduction in respect of the following items:

(i) **Insurance Premium:**

(a) The assessee is entitled to the deduction of the amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession.

(b) The amount of premium paid by federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by
a member of a co-operative society, being a primary society engaged in
supplying milk raised by its members to such federal milk co-operative
society.

(c) The amount of any premium paid by cheque by the assessee as an
employer to effect or to keep in force an insurance on the health of his
employees under a scheme framed in this behalf by—

A. the General Insurance Corporation of India formed under
Section 9 of the General Insurance Business (Nationalisation) Act,
1972 and approved by the Central Government; or

B. any other insurer and approved by the Insurance Regulatory and
Development Authority established under Sub-section (1) of Section

(ii) **Bonus:** Any amount paid by an employer to his employees as bonus or
commission for services rendered would be deductible. This deduction is
allowable only in cases where the amount of bonus or commission would not
have otherwise been payable to the employees as profits or dividend if it had
not been paid as bonus or commission.

Where the bonus is paid during the previous year in respect of an earlier year
in terms of an award made during the previous year by the Industrial
Tribunal, the deduction will be allowed during the previous year in which the
payment is made [Kalyana Mal Mills Ltd. v. C.I.T. (1965) 57 ITR p. 261].

Note that with effect from assessment year 1989-90 ceiling on bonus to be
allowed as deduction is proposed to be deleted. At the same time the bonus
payment shall be covered by the provisions of Section 43B so that they are
allowed as deduction only on actual payment basis.

(iii) **Interest on Borrowings:** The amount of interest paid by a going concern in
respect of capital borrowed for the purposes of business or profession would
be allowable as a deduction.

Provided that any amount of the interest paid, in respect of capital borrowed
for acquisition of an asset for extension of existing business or profession
(whether capitalized in the books of account or not); for any period beginning
from the date on which the capital was borrowed for acquisition of the asset
till the date on which such asset was first put to use, shall not be allowed as
deduction.

For the purposes of this allowance, recurring subscription paid periodically by
shareholders or subscribers in mutual benefit societies which fulfill such
conditions as may be prescribed under the Income-tax Rules would be
deemed to be capital borrowed and consequently interest thereon would be
allowable as a deduction. The deduction allowable to the assessee in respect
of interest on borrowings is not in any way related to the application of the
borrowed money for capital or revenue purposes. The only conditions are
that the borrowing must be genuine and the money borrowed must be utilized
by the assessee wholly and exclusively for the purposes of the business.
However, interest on capital contributed or loan given by partners of a firm
would not be allowable to the firm as deduction since the capital contributed
or loan given by the partners does not represent money borrowed by the firm. Similarly, interest on share capital cannot be claimed by the shareholders or allowed to a company as a deduction since share capital does not represent money borrowed by the company. However, interest on debentures would be allowable as a deduction although the money borrowed by way of debentures might have been utilized for investment in capital assets like buildings, machinery, plant or furniture or other assets.

However, if debenture loan is illusory and colourable, interest paid thereon is not allowable as a deduction.

Interest on capital borrowed for business, which is yet to be set up is not deductible. But interest on capital borrowed for expansion of business is allowable as a deduction.

Where the assessee firm, carrying on the business of suppliers to Government Department, had to borrow money for the purchase of Government Loan Bonds to obtain preference in securing orders for supply and claimed deduction of interest on such borrowed money it was held that the interest so paid was an admissible deduction under Section 36(1)(iii).

Interest on money borrowed by an assessee for the purpose of payment of income-tax would not be allowable under this section since income-tax liability is a personal liability of the assessee and cannot therefore, be treated as interest on money borrowed for the purposes of the business. Interest paid by the assessee for delayed payment of advance tax is not also deductible under this section because it does not represent interest on money borrowed.

**Case Laws:**

   
   Where the firm borrowed the money and lent to partners for personal purposes without interest, the interest paid by the firm on borrowed money will not be allowed because the amount was not borrowed for the purpose of the business.

   
   Where the assessee(dealer in shares) borrowed money in the course of business, the entire amount of interest is deductible as business expenditure and no apportionment is to be made against income assessable as dividend under head _Income from other Sources_ [.

   
   Where an assessee firm takes over the liability to repay the loan raised by another firm composed of same partners, interest paid by the assessee on loan is not deductible because the loan capital was not borrowed by the assessee for its own business. [.

4. **S.A. Builders Ltd. v. CIT (2007) 158 Taxmann 82 (SC):** If a Holding company has deep interest in a subsidiary company and funds transferred
from such Holding company to its subsidiary and the latter used it for any business purpose. Here the former is entitled to deduction of interest on borrowed loans.


In case of disallowance but of interest onus is on the revenue to prove that interest bearing borrowed funds have been utilized for some other purpose.

(iii) Discount on Zero Coupon Bond: Any discount given by the assessee as an employer by way of pro rata amount of discount on a zero coupon bond having regard to the period of life of such bond calculated in the manner prescribed would be deductible as business expenditure.

(iv) Contributions to Recognised Provident Fund, Approved Superannuation Fund: Any sum paid by the assessee as an employer by way of contribution towards recognised provident fund or an approved superannuation fund would be deductible in computing the business income of the employer. However, the contribution must be fixed on some definite basis by reference to the income chargeable under the head ‘Salaries’. This deduction is subject to the limits and conditions specified for this purpose under Income-tax Rules. According to Rule 88, the amount to be allowed as a deduction on account of an initial contribution which an employer may make in respect of the past services of an employee admitted to the benefits of a fund shall not exceed 25% of the employee’s salary for each year of his past services with the employer as reduced by the employer’s contribution, if any, to any provident fund (whether recognised or not) in respect of that employee for each year.

Where the company paid fixed salary plus commission at a fixed percentage of turnover achieved by the employee and contributed to the recognised provident fund on the salary plus commission, it was held to be allowable. [Gestetner Duplicators P. Ltd. v. C.I.T. (1979) 117 ITR 1 (S.C.).]

(iv) Contribution towards pension scheme: Any sum paid by the assessee as an employer by way of contribution towards a pension scheme, as referred to in section 80CCD, on account of an employee to the extent it does not exceed ten per cent of the salary of the employee in the previous year.

Explanation.—For the purposes of this clause, ‘salary’ includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites;

(v) Approved Gratuity Fund: Any sum paid by the assessee as an employer by way of contribution to an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust would be deductible as business expenditure. In the case of contributions to gratuity fund, normally the amount of contribution calculated on actuarial basis would be deductible although the liability to pay gratuity to employees may arise at a future point of time as and when the employee retires or dies.

(va) Deduction is allowed to an assessee in respect of any sum received by him from any of his employees to which the provisions of sub-clause (X) of clause 24 of Section 2 apply i.e., Contribution to any provident fund, Superannuation
fund, fund set-up under E.S.I. Act or any fund for welfare of employees, if such sum is credited by the assessee to the employee's account in the relevant fund or funds on or before the due date. "Due date" for the purposes of this clause means the date by which the assessee is required, as an employer to credit an employee's contribution to the employee's account in the relevant fund under any Act, rule, order or notification issued thereunder or under any standing order, award, contract of service or otherwise.

Hence, the contributions received by an employer towards provident fund, an approved superannuation fund or any fund under the ESI Act or any other fund are allowed to an assessee as deduction only if such amount is credited by the employer to the employee's account on or before the "due" date. The employer cannot, therefore, claim any deduction in respect of such accounts without "crediting" the employees' account with the money. If the amount is not deposited in time then it will not be allowed as deduction and employer's share will be treated as income.

(vi) **Animals**: In respect of animals, which have been used for purposes of the business or profession of the assessee otherwise than as stock-in-trade, a deduction would be allowable in the year in which the animals have died or have become permanently useless for the purpose of the business. The amount of allowance would be the difference between the actual cost of the animals to the assessee and the amount, if any, realised in respect of the carcasses of the animal.

(vii) (a) **Bad Debts [Section 36 (1)(vii) and (2)]:** The amount of any debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowed to be deducted. The deduction for bad debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or, of any earlier previous year, or, represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. In this respect, the following conditions are pre-supposed:

(i) **Relationship of debtor and creditor:** A bad debt pre-supposes the existence of a debt, and therefore, a relationship of debtor and creditor is essential. Unless there is an admitted debt and it becomes irrecoverable, it cannot be written off as a bad debt. **C.I.T. v. Vanguard Insurance Co. Ltd.** (1974) 97 ITR 546, 552 (Madras).

(ii) **The debt must be incidental to the business or profession:** The debt which is claimed as bad must be incidental to the business or profession carried on by the assessee. If the debt is not incidental to the business or profession, such a debt cannot be deducted as a bad debt. For example, in a solicitor's profession, it is not a part of that profession to advance money to clients who may require financial help to purchase properties, farms or stocks. It is immaterial that the advance is made by a solicitor for the purposes of attracting clients and to induce them to remain with him. Any loss arising from such a lending is not deductible. On the other hand,
payment of legal expenses of a law-suit under the client's instruction is incidental to the profession. If any amount remains unrecovered in respect of such expenses, it can be allowed as a bad debt against the profits of the profession.

Similarly, where an assessee carries on business in an agricultural produce and has to advance money to growers under an agreement to have the advances adjusted towards the price of the produce to be delivered to the assessee, the losses incurred in the event of such advance becoming irrecoverable, arise out of the business and can be deducted as bad debt C.I.T. v. Abdulakadar (1961) 41 ITR 545, 551 (SC).

In the business of money-lending, each and every lending may not be in the ordinary course of business. For example, where a money-lender invests his capital or accumulated profits in government securities, mortgages and debentures and suffers a loss on the investment, such a loss is capital loss and cannot be deducted as bad debt against the profits and gains of money-lending business. Sir Chinubhai Madhaval v. C.I.T. (1937) 5 ITR 210 (Bom.). Debts due from retiring partners are capital sums and the loss of such amounts cannot be written off and claimed as bad debts. Girdhari Lal Gian Chand v. C.I.T. (1971) 79 ITR 561 (All.).

(iii) Deduction in the year of writing off: No such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee for the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. The age of a debt is no doubt a relevant factor to be taken into consideration, but a time-barred debt is not necessarily bad: neither is a debt which is not time-barred necessarily good. BCGA (Punjab) Ltd. v. C.I.T. (1937) 5 ITR 279. A debt may have become time-barred but an assessee may not opt to claim it as bad if he relies on the honesty and integrity of the debtor. On the other hand, a debt may become bad even if it may not be time-barred. It is not necessary that a debt can be claimed as bad only if an assessee has failed to recover it through a court of law. Legal unenforceability of the claim does not prevent the amount from being a bad and irrecoverable debt for the purposes of taxation. Badrinarayan Balkrishan v. C.I.T. (1968) 69 ITR 323 (A.P.). Taking into account the precarious and shaky financial position of the debtor, a creditor may opt not to institute legal proceedings and waste his good money after bad money. The assessee must satisfy the Assessing Officer that in fact the debt or the loan has become irrecoverable in the accounting year in which a claim for deduction is made in respect thereof and it has been written off from the book.

(iv) Adjustment in the year of recovery: The deduction in respect of a bad debt is based on a mere estimate. Therefore, if the amount of
final recovery and the amount allowed as bad debt in respect of a bad debt falls short of the amount of such debt, such deficiency is further deductible in the year of final recovery. For example, an assessee claims a debt of ₹ 25,000 as bad in 1987-88. The Assessing Officer accepted a claim of ₹ 12,000 only. As a final settlement, the assessee recovered ₹ 8,000 in 1989-90 in respect of such debt. The amount of final recovery (₹ 12,000 + ₹ 8,000) falls short of the amount of the debt (i.e. ₹ 25,000). Such deficiency of ₹ 5,000 is deductible in the year in which the assessee writes it off in his books of account.

Conversely, if the amount of final recovery and the amount allowed as bad debt in respect of a debt exceed the amount of such debt, such excess is chargeable profit of the previous year in which such recovery is made [Section 41(4)]. It is immaterial whether the business or profession is in existence in such year or not. Continuing with the above example, if the amount of final recovery is ₹ 16,000, there is a taxable profit of ₹ 3,000 (₹ 16,000 + ₹ 12,000 - ₹ 25,000).

Note that recovery of bad debts is chargeable to tax as deemed profit [under Section 41(4)] if the recovery is made by the same person who got the allowance of the deduction. If the two entities are different the recovery of bad debt is not chargeable to tax [under Section 41(4)]. For example, a firm got the allowance of deduction in respect of bad debts. Subsequently, the firm is dissolved and it is taken over by one of the partners who recovers a part of the bad debt earlier allowed in the assessment of the firm. The partner is not assessable in respect of such recovery. C.I.T. v. P.K. Kaimil (1980) 123 IRE 755 (Madras).

(v) **No allowance for bad debts of a discontinued business:** No deduction is allowed for a bad debt of a business which has been discontinued before the commencement of the accounting year. Such a bad debt cannot be deducted from the profits of a separate existing business. Kameshwar Singh v. C.I.T. (1947) 15 ITR 248. An assessee can claim the deduction for a bad debt of a business which is carried on by the assessee for at least sometime during the previous year. It is not necessary that the business should be carried on throughout the previous year.

(vi) **Successor not entitled to write off predecessor’s debts:** The deduction of a bad debt can be claimed if the debt had been taken into account in computing the income of the assessee of that previous year or an earlier previous year unless it represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. Therefore, the debts of a predecessor-in-business may not be deductible in the hands of a successor-in-business. Thus, where the entire business of a partnership, after retirement of one of the partners, was taken over by the other partner who continued with the same stock-in-trade, he is not entitled to claim
a debt of the partnership as bad if the same is not realised. However, in certain cases even a successor is entitled to write off predecessor’s debts. On dissolution of the firm, if one of the partners takes over the business with all assets and liabilities and carries it on as successor, he is entitled to allowance when a debt originally due to firm becomes bad. It is merely an incident flowing from the transfer of the business together with its assets and liabilities, from the previous owner to the transferee. It is a right which should, on a proper appreciation of all that is implied in a transfer of a business be regarded as belonging to the new owner. (CIT v. T. Veerabhadra Rao, K. Koteswara Rao & Company (1985) 155 ITR 152 (SC).

If business is carried on without any break, change merely occurring in persons carrying on business would not disentitle business to claim deduction under this Section [E.A.V. Krishnamurty & Son v. CIT (1985) 152 ITR 640 (Mad.)].

Any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee.

(b) **Bad debts and provisions for bad and doubtful debts:** For Rural branches of Scheduled or non-scheduled Banks [Section 36(1)(vii) and (viia)]. A scheduled bank (not being a bank incorporated by or under the laws of a country outside India) or a non-scheduled bank is entitled to deduction in respect of provisions made for bad and doubtful debts relating to advances made by its rural branches upto 7.5% of gross total income (before allowing deduction under this clause) and Chapter VI-A, i.e. any deduction under Sections 8C to 80U] + an amount not exceeding 10% of the aggregate average advances made by the rural branches of such bank. An option has been given to a scheduled bank (not being a bank incorporated by or under the laws of a country outside India) or to a non-scheduled bank; to claim a deduction, in relevant assessment years, in respect of any provisions made by it for any assets classified by the RBI as doubtful asset or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding ten per cent of the amount of such asset shown in the books of account of the bank on the last day of the previous year. Relevant assessment years here means five consecutive assessment years commencing on or after the 1st day of April 2000 and ending before 1.4.2005. A bank incorporated under the laws of a country outside India will be allowed a deduction upto 5% of the gross total income (as computed above).

Provided also that a Scheduled bank or non-Scheduled bank referred to in this sub-clause shall as its option be allowed a further deduction in excess of 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 third proviso
unless such income has been disclosed in the return of income under the Head profits and gains from business or profession.

For Public Financial Institution or State Industrial Investment Corporation with effect from 1.4.1992, an amount of 5% of the total income as computed in the manner explained above, is allowed as a deduction.

An option has been given to public financial institution or a State Financial Corporation or a State Industrial Investment Corporation 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 ten per cent 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.

For this purpose, a branch situated in a place with a population not exceeding 10,000 will be regarded as a rural branch. The relevant figures of population have to be taken as per the last preceding census which has been published before the first day of the previous year. The aggregate average advance qualifying for the deduction will be computed in the following manner under Rule 6ABA:

(a) The amount of advances made by each rural branch, as outstanding at the end of the last day of each month comprised in the previous year is to be aggregated separately;

(b) The sum so arrived at in case of each such branch is to be divided by the number of months for which the outstanding advances have been taken into account for the purpose of clause (a);

(c) The aggregate of the sums so arrived at in respect of each of the rural branches comprises the aggregate average advances made by the rural branches of the scheduled banks.

Such bank is required to debit the amount of bad and doubtful debts to the "provisions for bad and doubtful debts account". If the amount of bad debts exceeds the credit balance, only such excess is to be allowed as bad debt. If the amount of bad debt is not debited to the provisions for bad and doubtful debts account, no deduction is allowed for bad debts.

-Scheduled Bank" means the State Bank of India constituted under the State Bank of India Act, 1955, a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959, a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 but does not include a co-operative Bank.
- Public financial institution” shall have the meaning assigned to it in Section 4A of the Companies Act, 1956.
- State financial corporation” means a financial corporation established under Section 3 or Section 3A or an institution notified under Section 46 of the State Financial Corporations Act, 1951.
- State industrial investment corporation” means a Government company within the meaning of Section 617 of the Companies Act, 1956 engaged in the business of providing long-term finance for industrial projects and eligible for deduction under Clause (viii) of this sub-section.

(viii) Special reserves created by Financial Corporations: Special reserve created by financial corporation engaged in providing long-term finance for industrial or agricultural development in India or development of infrastructure in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purpose, is deductible to the extent of 40% of income from such activity.

Condition to be fulfilled to get the above deduction:
(i) The aggregate of the amounts carried to such reserve account from time to time do not exceed twice the amount of the paid-up share capital of the corporation, or the company and its general reserves.

In this clause
(a) -financial corporation” shall include a public company and a government company;
(b) -public company” shall have the meaning assigned to it in Section 3 of the Companies Act, 1956; and
(c) -government company” shall have the meaning assigned to it in Section 617 of the Companies Act, 1956.

In terms of Section 41(4A) any withdrawal from such special reserve would be deemed to be the profits and gains of business even if the business is closed down.

(ix) Expenditure on Family Planning: In the case of companies any bona fide expenditure incurred for the purpose of promoting family planning amongst the employees would be deductible. In cases where the expenditure is wholly or partly in the nature of a capital expenditure, the deduction allowable to the company in respect of the capital expenditure would be a sum equal to 1/5th in each year of the expenditure in respect of the accounting year in which it was actually incurred and 1/5th of each of the subsequent four years immediately following that year. The unabsorbed part of the capital expenditure on family planning incurred by the companies would be treated in the same way as unabsorbed capital expenditure on scientific research or unabsorbed depreciation and could be carried forward indefinitely without any time limit in cases where the profits of the assessee are not sufficient to cover the amount as allowable.

(x) Expenditure incurred by Corporation or a Body Corporate: Any expenditure which is not being in the nature of capital expenditure incurred
by a corporation or a body corporate, by whatever name called, constituted or established by a Central, State or Provincial Act, is notified by the Central Government in the official Gazette and the expenditure incurred for the objects and purposes authorised by the Act under which such corporation or body corporate was constituted or established, is deductible.

(xii) Any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries as the Central Government may by notification in the official gazette specify.

(T) Other Expenses not covered by the Previous Deductions

Section 37(1) of the Income-tax Act provides for allowance in respect of any other item of expenditure not covered by any of the provisions contained in Sections 30 to 36 discussed above. This deduction is subject to the following conditions:

(i) The expenditure must have been laid out or expended by the assessee wholly and exclusively for the purposes of his business or profession.

(ii) The expenditure should not be in the nature of a capital expenditure.

(iii) The expenditure should not represent any item of personal expenditure of the assessee.

(iv) The deduction claimed should not cover any of the items of the expenditure which are specifically disallowed under the Act.

For the purpose of allowance of expenses under this section, it is not essential that the expenditure in question must necessarily have resulted in the earning of income or profits by the assessee. Further, it is enough if the expenditure is incurred wholly and exclusively for the purposes of the business although it is not necessary for the assessee to prove that the expenditure is unavoidable or that the expenditure has been incurred out of business necessity. The assessee would be entitled to the allowance if he could prove that the expenditure is justified and has been incurred by reason of commercial expediency. Whether the particular expenditure is incurred in compliance with some other law for the time being in force or not the assessee would still be entitled to the deduction. Since capital expenditure has been specifically disallowed by the provisions, care must be taken to ensure that a proper distinction is made between expenses of a capital nature and those of revenue nature because only revenue expenses would qualify for allowance under this section. The broad test is to determine whether the expenditure has resulted in the acquisition of a capital asset or property. To put it in other words, whether such expenditure has resulted in giving to the assessee a benefit of an enduring nature. The expression “enduring” used in this context should not be mistaken to mean ever-lasting or eternal nature but if the benefit of an expenditure is so transitory or ephemeral as to be not in existence for some period the expenditure in question must be treated as being of a revenue nature. The taxability or otherwise of the expenditure in the hands of its recipient or income would be irrelevant in determining the allowability or otherwise of the amount to the assessee. Care should also be taken to distinguish between expenses incurred for the purpose of the business to earn income and payments which are alleged to be expenses which, however, are really in the nature of diversion of profits. The allowability or otherwise of an item of expenditure under this section would be a question of facts and law and the ultimate conclusion would be the decision of the
High Court of the Supreme Court, as the case may be. For a detailed study of the various items of expenses which are allowable or disallowable under this section, students may refer suggested readings.

An explanation has been added by Finance (No. 2) Act, 1998 to clarify that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by Law shall not be allowed.

Some of the examples of allowable expenses under Section 37(1) are:

(i) Expenditure incurred on raising loans or issuing debentures but not on issuing share capital.

(ii) Legal expenses incurred:
   (a) to avoid a business liability, e.g. for alleged breach of a trading contract;
   (b) to defend the assessee's title to his assets, e.g. land, building, etc.;
   (c) to secure the termination of a disadvantageous trading relationship, e.g. removal of an undesirable employee;
   (d) by a director of a company in defending a suit brought to challenge the validity of his election to the directorship;
   (e) to protect the capital asset of the business which has already been acquired;
   (f) by a company in resisting a winding up petition by some shareholders;
   (g) for defending monopoly rights;
   (h) incurred in restraining another company from using assessee's trade mark.

However, the expenses incurred in criminal proceedings are not allowable. Legal expenses relating to acquisition of capital asset for a business are capital expenses and as such, not allowable.

In this connection the Supreme Court held that where litigation expenses are incurred by the assessee for the purpose of creating, curing or completing his title to the capital, then the expenses incurred must be considered as capital expenditure. But if the litigation expenses are incurred to protect the business of the assessee, they must be considered as a revenue expenditure. [Dalmia Jain & Co. v. C.I.T. (1971) 81 ITR p. 754 (S.C.).]

Expenditure for prosecuting civil proceedings is deductible provided the expenditure was laid out for the purpose of the business wholly and exclusively i.e. to promote the interest of the business. [Sree Meenakshi Mills v. C.I.T. (1976) 63 ITR, p. 207 (S.C.)]

(iii) Bonus to employees under an industrial award.

(iv) Expenses for the installation of new telephone.

(v) Sales tax is an admissible deduction but not estate duty.

(vi) Interest on unpaid purchase price of goods or capital assets.

(vii) Expenditure incurred to oppose nationalization or to prevent extinction of business. However, the donations given for the political parties or for political cause are not admissible deductions under Section 37.

(viii) Subscriptions given are allowed if their payment is compulsory or commercially expedient and of benefit to the payer.
(ix) Expenses incurred on the occasion of festival or customary days are allowed up to a reasonable amount keeping in view the size of the business and subject to the satisfaction of the Assessing Officer that the expenses are not expenses of personal, social or religious nature.

(x) Recurring expenses incurred on imparting basic training to apprentices under the Apprentices Act, 1961 is deductible.

(xi) Initial expenditure on the first installation of fluorescent tube lights is treated as Capital expenditure and hence not deductible but all subsequent expenditure for replacement of tubes is treated as revenue expenditure and hence deductible.

(xii) Loss through embezzlement by an employee is deductible.

(xiii) Professional tax paid by a person carrying on business or trade is allowed as deduction.

(xiv) Annual listing fee paid to stock exchange is allowed as deduction.

(xv) Expenses incurred on Civil defence measures as specified by the Board, even when there is no emergency, is deductible.

(xvi) Brokerage paid for raising loan to finance business.

(xvii) Stamp and registration charges for the purpose of entering into agreement for obtaining overdraft facilities.

(xviii) Security deposited with postal authorities for telex connection deductible as business expenditure. However, when the amount is returned by postal authorities, when the telex connection is finally closed, the refund shall be treated as an income of the assessee of the year in which the amount is refunded.

(xix) Compensation payable as a result of negligence in carrying on a business or termination of an employee, director or agent.

(xx) Compensation to an employee for injury sustained or accident met with while on duty.

(xxi) Royalty paid for mining, patents or copyrights.

(xxii) Insurance premiums: Premium for insurance of building, plant, machinery, furniture, stock or stores are allowable under specific sections, e.g., premium paid by a businessman under a policy insuring its employees or experts against death or injury, or insuring the employer against liability for compensation in respect of accidents to its workmen or against loss of trading licence.

(xxiii) Penalty paid by the assessee for saving from confiscation of the goods which he has purchased from a third-party without knowing that they had been illegally imported.

(xxiv) Pension, gratuity or other voluntary payment made to the employees are deductible but a gratuity paid to a single employee when it was not the practice of the business was treated as disallowable expense. In the same way voluntary pensions and lump sum payments made by a company to its employees on its winding up were not allowed.

(xxv) Bona fide expenditure of a revenue nature incurred for the welfare of employees on its winding up was not allowed.

(xxvi) Excessive price paid out of extra commercial considerations shall be disallowed.
(xxvii) Sum paid by the assessee as a surety when it is not part of his business shall be disallowed.

(xxviii) Presents given to employees by way of gift and not as perquisites for services rendered, shall be disallowed.

In this connection certain decisions are as under:


2. Legal expenses incurred in defending a suit filed by the shareholders for injunction against distribution of dividend in specie, are not allowable because the expenditure had nothing to do with the carrying on of the business and was not incidental to it. [Raza Buland Sugar Co. Ltd. v. C.I.T. (1980) 122 I.T.R. p. 817 (Delhi)].


4. Where the assessee maintains accounts on mercantile system but does not provide for payment of bonus, he is entitled to the deduction for the payment of bonus, since it is a liability under Payment of Bonus Act, 1965. [Ram Singh & Sons v. C.I.T. (1981) I.T.R. 131 p. 622 (All.)].

5. Gratuity paid by the assessee to its employees at the time of its merger with other bank, was allowed. [C.I.T. v. Srinivasa Perumal Bank Ltd. (1981) 131 p. 692 (Mad.)].

6. When a Commission of Enquiry was appointed to enquire into administration of affairs of companies including assessee, amount spent in connection with enquiry (legal fees, hotel expenses, travelling expenses etc.) were allowable as a business expense. [South Asia Industries (P) Ltd. v. C.I.T. (1981) 132 I.T.R. p. 144 (Delhi)].


9. Where the undertaking of assessee is taken over by the Government, and compensation is referred to arbitration, expenditure incurred by the assessee, in maintaining establishment in order to get maximum compensation by pursuing matters with authorities and arbitration, is an allowable deduction. Similarly retrenchment compensation paid to workers is allowable deduction. [Ambala Cantt. Electricity Supply Corporation Ltd. v. C.I.T. (1982) 133 I.T.R. p. 343 (P. & H.)].

10. The expenditure incurred in registering for the first time the trade mark is revenue expenditure and an allowable deduction [C.I.T. v. Finlay Mills Ltd. (1951) 20 I.T.R. p.475 (S.C.)].

11. Where a company took over assets and allotted shares for part of the price and paid interest on balance of the price, it was held that the interest paid
was business expenditure. [*Bombay Steam Navigation Co. v. C.I.T.* (1965) 56 I.T.R. p.52 (S.C.).]

(12) Where a part of the commission is given up for reasons of commercial expediency and is incurred for own benefit in future, it is a deductible expense. [*C.I.T. v. Chandu Lal Keshav Lal & Co.* (1960) 38 I.T.R. p. 601 (S.C.).]

(13) Where the assessee had contested the sales tax liability (liability incurred on sales made during the accounting year) in appeals and he had made no provision for its payment, even then he is entitled to deduction for such liability because the liability to sales tax arose on sale made by him. [*Kedar Nath Jute Mfg. Co. Ltd. v. C.I.T.* (1971) 82 I.T.R. p. 363 (S.C.).]

(14) Fine paid to release goods, imported contrary to law and confiscated, is not a deductible expenditure. [*Haji Aziz and Abdul Shakoor Bros. v. C.I.T.* (1961) 41 I.T.R. p. 35 (S.C.).]

(15) Where the assessee neither had any scheme for payment of gratuity nor did it pay such gratuity in practice but paid a gratuity to an employee in appreciation of his long and valuable services to the company is not an expenditure laid out for the purpose of the carrying on of the business of the company, hence disallowed. [*Golden Woodroffe Leather Mfg. Co. Ltd. v. C.I.T.* (1962) 41 I.T.R. p. 551 (S.C.).]


However, where the assessee was unable to work the looms to the extent of loom hours allotted to it and it sold certain loom hours the consideration was held to be capital receipt since it disposed of its capital. [*C.I.T. v. Maheshwari Devi Jute Mills Ltd.* (1965) 57 I.T.R. p. 36 (S.C.).]


(19) The amounts spent for giving presents to the members of the assessee-society on the occasion of the silver jubilee were expenditure incurred wholly for keeping alive its good image amongst its members. Further, the amount was not spent for advertisement and the provisions of Section 37(3) and Rule 6B were not attracted.


(21) To determine the nature of expenditure (whether capital or revenue) emphasis is not placed whether it is derived out of profits or revenues. [*Schnedectly Beck India Ltd. v. CIT* (2004) 91 ITD 23 (Mum.) (TM)].
Certain Allowable Losses

Losses which are directly incidental to the business or profession of the assessee are allowable. Following are some examples of such losses:

(1) Robbery or Dacoity: Loss caused by robbery or dacoity is not deductible. But, if it is incidental to business it will be allowed as a deduction and this depends upon the specific circumstances and conditions. For example, if cash is sent for disbursement at different centers by a sugar factory in rural area, it is incidental to business and is, therefore, allowed. Any loss due to robbery in a bank will be allowed as the bank is under an obligation to maintain some cash outside the storeroom for payments.

(2) Embezzlement, Theft, etc.: The loss of money due to embezzlement by an employee handling the funds of the business while discharging his official duties is allowed as deduction. It is deductible when discovered. When an employee goes to bank to deposit the cash or takes cash with him for disbursement and he takes away the money for his own use, even then, the loss is allowable. Theft by a cashier, who is in charge of cash is also an allowable loss. A theft committed either by an employee or by someone else by breaking open into the business premises after office hours, is also allowable.

(3) Loss due to Non-recovery of advances: If it is the practice in a business to give advance money to the suppliers and if the supplier neither supplies the order nor refunds the advance money, the loss sustained by the assessee is incidental to business and is, therefore, allowable.

5.21 EXPENSES RESTRICTED/DISALLOWED

(i) Political expenditure disallowed: Any expenditure incurred by an assessee for purpose of advertisement in any souvenir, brochure, tract, pamphlet and the like published by a political party will not be allowed as a deduction in computing the taxable profits.

(ii) Limits of Reserve for Unexpired Risks: Rule 6E of the Income-tax Rules provides that in computing the income from any business from insurance (other than life insurance), the deduction in respect of the amount carried to reserve account for unexpired risks, including the amount of additional reserve for this purpose, shall be restricted to - (i) in the case of fire or miscellaneous insurance business, 50% of the net premium income of the business of the previous year, and (ii), in the case of marine insurance business, 100% of the net premium income of the accounting year concerned. If, however, the amount of reserve or additional reserve is in excess of the aforesaid limits, the excess would be disallowed for computing the income of the relevant accounting year, but such disallowed portion of the reserve would not be again included in the total income of the next year for purpose of assessment. For this purpose, the expression ‘net premium income’ should be taken to mean the amount of premium received minus the amount of reinsurance premium in respect of the relevant accounting year paid or payable by the assessee and the expression marine insurance includes Export Credit insurance.
(iii) **Interest Payable Outside India:** Under Section 40(a)(i), deduction is not allowed in respect of any interest (not being interest on a loan issued for public subscription before 1.4.1938), royalty, fees for technical services or other sum chargeable under the Income-tax Act, which is payable outside India or in India to a non-resident, not being a company or to a foreign company and on which tax has not been deducted or after deduction, has not been paid before the expiry of the time prescribed under Sub-section (1) of Section 200. In case where tax is paid or deducted in a subsequent year, the benefit of deduction from gross total income will be allowed in computing the income of the previous year in which such tax has been paid.

(iiiia) any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139.

**Provided** that where in respect of any such sum, tax has been deducted in after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

(iiiib) any sum paid on account of securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

(iiiic) any sum paid on account of fringe benefit tax under Chapter XII-H shall be disallowed.

(iv) **Rate or Tax Paid on Profits:** Under Section 40(a)(ii), any sum paid by the assessee on account of any tax or rate levied on profits on the basis of or in proportion to the profits and gains of any business or profession, would be disallowed in full. For example, income-tax, foreign income-tax or a professional tax levied under the Municipal Act on persons who exercise a profession, trade or calling within the municipal limit shall be disallowed.

Explanation 1 to sub-clause (ii) of clause (a) of Section 40 has been inserted to clarify that any sum paid outside India and eligible for relief of tax under Section 90 or deduction from the Income Tax payable under Section 91 is not allowable and deemed to have never been allowable as a deduction under Section 40 of the Income Tax Act. However, the tax payers will continue to be eligible for tax credit in respect of Income Tax paid in a foreign country in accordance with the provisions of Section 90 or Section 91 as the case may be.

Explanation 2 has been inserted w.e.f. 1.6.06 to provide that any sum paid outside India and eligible for relief of tax under new Section 90A will not be allowed as a deduction in computation of profit and gains from business or professions.

(v) **Wealth Tax [Section 40a(iiia)]:** Any wealth-tax paid or payable by the assessee in respect of his business assets would be totally disallowed. It is
immaterial whether the wealth-tax is assessed and payable in India or in foreign country in respect of the business assets of the assessee.


(vi) **Salaries [Section 40a(iii)]:** Any payment which is chargeable under the head „salaries“ if it is payable—

(A) outside India; or

(B) to a non-resident

and if the tax has not been paid thereon or deducted thereon under Chapter XVII B of the Act.

(vii) **Payment to Provident Funds etc. [Section 40a(iv)]:** Any payment to a Provident Fund or other fund established for the benefit of employees of the assessee would be disallowed in cases where the assessee (employer) has not made effective arrangements to secure deduction of tax at source from any payment made from the fund which are chargeable to tax under the head „salaries“ in the hands of the employees.

(viii) **Payment of tax on non-monetary perquisites [Section 40a(v)]:** Tax actually paid by an employer under Section 10(10CC) shall not be deducted in computing the income chargeable under the head „Profit and gains of business or profession“.

(ix) **Payment to Partners:** The new provision of Section 40(b) which is substituted by the Finance Act, 1992 with effect from the assessment year 1993-94, provides as follows:

In the case of a firm which is assessable as such:

(a) any payment of salary, bonus, commission or remuneration by whatever name called to a partner other than a working partner would not be allowed as deduction in the hands of the firm;

(b) any remuneration paid to a working partner or interest paid to any partner, which is not authorised by or not in accordance with the terms of the partnership deed would not be allowable deduction in the hands of the firm;

(c) any remuneration paid to a working partner or interest paid to any partner which is authorised by or is in accordance with the terms of the partnership deed but which relates to any period falling prior to the date of such partnership deed would not be allowable. However, in relation to any payment of remuneration to the partner during the previous year relevant to the assessment year 1993-94, the terms of the partnership may at any time during the said previous year, provide for such payment.

(d) any interest which is paid in accordance with the terms of the partnership deed and relates to any period falling after the date of such partnership deed but which is in excess of simple interest @ 12% p.a., w.e.f. 1.6.2002 would not be allowable.
Further, interest paid by the firm to a person in his representative capacity (i.e. on behalf or for the benefit of any other person) and the interest paid by the firm to the person who is so represented shall also be subject to the limit laid down in this clause.

However, where a person is a partner in his representative capacity in the firm, the interest paid to him by the firm otherwise than as partner in a representative capacity will not be subject to the limit laid down in this clause. Again, where a person is a partner in a firm in his own capacity (and not as a partner in a representative capacity), interest paid by the firm to him shall not be taken into account for the purposes of this clause if such interest is received by him on behalf of or for the benefit of any other person.

(e) any remuneration to a working partner which is authorised by and is in accordance with the terms of the partnership deed and in relation to any period falling after the date of partnership deed is an allowable deduction subject however, to the condition that the maximum amount of such payment made to all the partners during the previous year should not exceed the limits given below:

<table>
<thead>
<tr>
<th>Quantum of Book Profit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto ₹ 3,00,000 or in case of a loss</td>
<td>₹ 1,50,000 or 90% of the Book profit, whichever is more</td>
</tr>
<tr>
<td>on the balance</td>
<td>60%</td>
</tr>
</tbody>
</table>

For the purposes of this clause, ‘working partner’ means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner; and

‘Book profit’ means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in chapter IV-D (i.e. Sections 28 to 44D) as increased by the aggregate amount of remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.

(x) **Payment by AOPs / BOIs [Section 40(ba)]:** In the case of an association of persons or body of individuals (other than a company or a Co-operative Society or a society registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India) any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such association or body to a member of such association or body shall not be allowed as a deduction.

As per explanation 1 to clause (ba) of Section 40, where interest is paid by the association or body to any member thereof, who has also paid interest to the association or body, the disallowance shall be restricted to the amount paid by the association or body to the member, after deducting therefrom the amount paid by the member to the association or body.

Explanation 2 further specifies that in the case of a member in a
representative capacity, the interest paid by the association or body to such a person in his individual capacity and not as in his representative capacity, shall not be taken into account. However, any interest paid to such person in his representative capacity shall be taken into account.

Where an individual is a member otherwise than as a member in a representative capacity of an AOP or BOI, interest paid to such person by the AOP or BOI shall not be taken into account for the purposes of this clause if such interest is received by the person on behalf of or for the benefit of any other person.

(xi) **Payment to Relatives or Associates [Section 40A(2)]:** Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person specified below and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable, having due regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is considered to be excessive or unreasonable must be disallowed in computing the assessee's income from business or profession.

The specified persons, the payments to whom may fall for disallowance under this section are the following:

(a) Where the assessee is an individual - any relative of the assessee.

(b) Where the assessee is a company, firm, association of persons or H.U.F. any director of the company, partner of the firm, member of the association or family, or any relative of such director, partner or member.

(c) Any individual who has a substantial interest in the business or profession of the assessee or any relative of such individual.

(d) A company, firm, association of persons or H.U.F. having substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family or any relative of such director, partner, or member as the case may be.

(e) A company, firm, association of persons or H.U.F. of which a director, partner or member, as the case may be, has substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family or any relative of these persons.

(f) Any person who carries on a business or profession in cases where the assessee is an individual or any relative of the individual or a person having substantial interest in the business or profession of that person or where the assessee is a company, firm, association of persons or H.U.F. any director of such company, partner of such firm, member of the association or family, or any of their relatives who has a substantial interest in the business or profession of that person.
For the purpose of this disallowance, a person must be deemed to have substantial interest in a business or profession - (i) in cases where the business or profession is carried on by a company, if such person is the beneficial owner at any time during the relevant accounting year of equity shares carrying not less than 20% of the total voting power, and (ii) in other cases, if such person is at any time during the accounting year, beneficially entitled to not less than 20% of the profits of such business or profession.

(xii) **Cash Payments exceeding ₹20,000:** Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.

(3A) Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day, exceeds twenty thousand rupees:

Provided that no disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3) and this sub-section where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

Provided further that in the case of payment made for plying, hiring or leasing goods carriages, the amount shall not exceed thirty-five thousand rupees instead of twenty thousand rupees.

Under Rule 6DD of the Income-tax Rules, the following categories of payments are exempt for the purposes of this requirement. Consequently, the provisions of Section 40A(3) do not apply to the following cases and circumstances:

(i) Payments which are made to the Reserve Bank of India, State Bank of India or other banking institutions, including co-operative banks and land mortgage banks, primary credit societies, Life Insurance Corporation of India, Unit Trust of India and certain specified institute providing Industrial Finance.

(ii) Payments, which under the contracts entered into prior to 1.4.1969 have to be made only in legal tender.
(iii) Payments made to the Central or State Governments which under the Rules framed by the Government are required to be made in legal tender.

(iv) Payments in villages and towns having no banking facility, to persons ordinarily residing or carrying on business or profession in such villages or towns.

(v) Payments by means of book adjustment by the assessee in the account of the payee against money due to the assessee for any goods supplied or services rendered by him to the payee.

(vi) Payments made by any Letter of Credit arrangement through bank, a mail or telegraphic transfer through bank, a book adjustment from any account in a bank to any other account in that or any other bank and a bill of exchange made payable only to a bank.

(vii) Payments of terminal benefits such as gratuity, retrenchment compensation, etc. to low paid employees, i.e., whose annual salary does not exceed ₹ 7,500 or to the members of their families. In view of the limit of ₹ 20,000 in Section 40A(3) the amount needs to be revised to ₹ 20,000.

(viii) Payments made to cultivators, growers or producers for the purchase of agricultural or forest produce, animal husbandry products including hides and skins, products of dairy or poultry farming, products of horticulture or fish, products of cottage industry run without the aid of power.

(ix) Where the payment is made to an employee temporarily but for a minimum period of fifteen days in a place other than his normal place of duty or on a ship provided tax has been deducted at source in terms of Section 192 of the Act and provided further that such employee has no bank account at such place of temporary posting or ship.

(x) Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike.

(xi) Where payment is made to an agent who in turn is required to make payment in cash for goods or services on behalf of the assessee.

(xiii) **Provision for Gratuity [Section 40A(7)]**: No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason. However, any provision made by the assessee for the payment of a sum by way of any contribution towards an approved gratuity fund or for the purpose of payment of any gratuity that has become payable during the previous year shall be allowed.

Where any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason has been allowed as a deduction in computing the income of the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way of gratuity to any employee shall not be allowed
as a deduction in computing the income of the assessee of the previous year in which the sum is so paid.

2. **Restriction on contribution by employers to non-statutory funds** [Sections 40A(9), (10) and (11)]:

With a view to discouraging creation of irrevocable or discretionary trusts funds, companies, associations of persons, societies, etc. the Finance Act, 1984 has provided that no deduction shall be allowed in the computation of taxable profits in respect of any sums paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals or society or any other institution for any purpose, except where such sum is paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals or society or any other institution for any purpose, except where such sum is paid or contributed (within the limits laid down under the relevant provisions) to a recognised provident fund or an approved gratuity fund or an approved superannuation fund or for the purposes of and to the extent required by or under any other law.

It is further provided that where the Assessing Officer, is satisfied that the fund, trust, company, association of persons, body of individuals, society or other institution referred above has, before March 1, 1984 *bona fide* laid out or expended any expenditure (not being in the nature of capital expenditure) wholly or exclusively for the welfare of the employees of the assessee out of the sum referred above, the amount of such expenditure shall, in case no deduction has been allowed to the assessee in respect of such sum, be deducted in computing the business income of the assessee of the previous year in which such expenditure is so laid out or expended. It is also provided that where the assessee has before March 1, 1984, paid any sum to any fund, trust, company, association of persons, body of individuals, society or other institutions, then notwithstanding anything contained in any other law or in any instrument, he would be entitled:

(a) to claim the unutilised amount be repaid to him and where any claim is so made, the unutilised amount shall be repaid, as soon as may be, to him; and

(b) to claim that land, building, machinery, plant and furniture acquired or constructed by the fund, trust, company, association of persons, body of individuals, society or other institution out of the sum paid by the assessee, be transferred to him and where any claim is so made, such asset shall be transferred, as soon as may be to him.

The aforesaid provisions took effect retrospectively from 1st April, 1980, and accordingly, apply in relation to the assessment year 1980-81 and subsequent years.

3. **Disallowance of unpaid statutory liability** (Section 43B):

Under the income-tax law, a person carrying on a business or profession can account for his income either on cash or mercantile basis. The latter, however, have to reckon with the restrictions contained in Section 43B. This section cuts into the freedom of a business to claim certain specified expenses on due basis. The section has broadly divided the targeted expenses into two i.e., according to section 43B
even if an assessee maintains books on mercantile system then he will be allowed exemption of the following expenses only on payment basis. In the first category are:

(a) taxes, duties, cess or fees payable under any law;
(b) bonus and commission to employees;
(c) interest to public financial institutions, state financial corporations, state industrial investment corporations and to scheduled banks in respect of term loans or advances;
(d) leave encashment.
(e) any sum payable by employer by way of contribution to provident fund or super annuation fund or any other fund for welfare of employees.

These four sets of expenses outstanding at the end of the previous year would be allowed as deduction only to the extent they have been actually paid on or before the due date of filing the income-tax return failing which they would be allowed in the previous year they have been actually paid. Where interest as stipulated in (d) above is converted into a loan, borrowing or advance and is not paid, interest so converted will not be treated as having been actually paid, and accordingly, will not be allowed as a deduction from business income.

The second category deals with employers’ contribution to provident fund superannuation fund, gratuity fund or any other fund for the welfare of employees. No deduction on this account shall be allowed unless payment is made to the appropriate authority like the Provident Commissioner in case of PF contribution on or before the due date set out in the relevant statute like the PF Act. In case the payment was made otherwise than by cash, the sum should have been realised within 15 days of such due date. For example, if PF contributions are to be handed over to the relevant authority within a month from the end of the month in which it was deducted from employees’ salary and the employer for the month of August 99 deductions makes the payment say in the month of October 99, he will lose the benefit of deduction in so far as contributions to PF for the month of August 99 are concerned.

However, Finance Act, 2003 has omitted the second proviso and therefore PF and ESI contribution will be allowed as deduction even if they are not paid within due date specified under relevant Acts.

5.22 DEEMED PROFITS

Section 41 of the Income-tax Act enumerates items of notional income which are deemed to be income from business or profession chargeable to tax. The liability to tax in respect of deemed profits would arise not only during the existence of the business but also after its discontinuance. The items of deemed profits are enlisted below:

(i) **Remission of Liability or Recoupment of Loss or Expenditure:** Where any allowance or deduction has been made in the assessment for any year in respect of losses, expenditure or trading liability incurred by the assessee and subsequently the assessee or his/its successor in business has obtained, whether in cash or in any other manner whatsoever, any
amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof during any subsequent accounting year, the amount so obtained or the value of the benefit so accruing to the assessee or his/its successor in business as the case may be, must be deemed to be the profits and gains of business or profession and must be charged to tax as the income of the assessee or his/its successor in business as the case may be for the year in which the remission or cessation takes place. This tax liability would arise irrespective of the fact whether the business or profession in respect of which the allowance or deduction has been made is being continued to be carried on by the assessee in the year of remission of liability or not. For instance, if sales tax is paid by the assessee in the year 1998-99 and the assessee gets a refund of sales-tax previously paid in the year 1999-2000, the refund would be taxable as the assessee’s income of 1999-2000. But the taxability of any deemed profit on account of remission of liability or recoupment of loss would arise only if the liability in question or the amount of the loss was previously allowed as a deduction in computing the business income of the assessee. For instance, if the income-tax assessment for the year in which the expenditure or loss was claimed was made exparte or was a best judgement assessment and the income was estimated, it cannot be said that the expenditure was actually allowed as a deduction in the assessment. Consequently, if there is a remission of the liability subsequently, the assessee cannot be brought to charge in respect of the same. The Finance (No. 2) Act, 1996 has clarified that unilateral write back of any liability would be taxable as deemed income.

“Successor in business” means -

(i) in case of amalgamation of companies the amalgamated company;
(ii) where the first mentioned person is succeeded by any other person in that business or profession, the other person;
(iii) where a firm carrying on business or profession is succeeded by another firm, the other firm;
(iv) where there has been a demerger, the resulting company.

(ii) Where any building, machinery plant or furniture owned by the assessee and used for the purpose of business for which depreciation under Section 32(1)(i) is claimed, is sold, discarded, demolished or destroyed and the money payable together with scrap value in respect of such assets exceeds the written down value, the excess to the extent of difference between the actual cost and the written down value shall be taxable as business income in the previous year in which the moneys payable become due.

Even if in the year the moneys payable becomes due, the business for which these assets were used is no longer in existence, the provisions of this section shall apply as if the business is in existence in that previous year.

(iii) Capital expenditure on Scientific Research: Where an assessee incurs capital expenditure on scientific research, the entire amount of such expenditure is allowable as a deduction in computing the business income of
the assessee in the same year in which the expenditure is incurred. If subsequent to the incurring of the expenditure, the asset representing the capital expenditure is sold, without having been used for other purposes, the assessee would be liable to pay tax on the excess of sale proceeds together with the deduction allowed earlier over the amount of capital expenditure or the amount of deduction allowed earlier whichever is less.

Further, the assessee is liable to pay tax on the balancing charge even if the assessee's business is not in existence during the previous year in which the money payable in respect of any asset becomes due.

Explanation: For the purpose of Sub-section (3) -

(1) “moneys payable in respect of any building, machinery, plant or furniture” includes -

(a) any insurance, salvage or compensation moneys payable in respect thereof;

(b) where the building, machinery, plant or furniture is sold, the price for which it is sold,

so however, that where the actual cost of a motor car is, in accordance with the proviso to clause (1) of Section 43, taken to be twenty-five thousand rupees, the moneys payable in respect of such motor car shall be taken to be a sum which bears to the amount for which the motor car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of twenty-five thousand rupees bears to the actual cost of the motor car to the assessee as it would have been computed before applying the said proviso;

(2) “sold” includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian Company.

(iv) **Recovery of Bad Debts:** Where the assessee claims a deduction in any year in respect of a debt which has become bad or irrecoverable and the Assessing Officer allows a deduction to the extent of the bad debts, if subsequently the assessee recovers either the full amount of the debt which was previously written off as bad or part thereof, the amount so recovered would be chargeable to tax as the business income of the assessee in the year of recovery. But if the amount claimed by the assessee as bad debt was previously disallowed by the Assessing Officer on the ground that it had not actually become bad or it was not written off by the assessee, when the money is recovered, there would be no liability to tax in respect thereof. In cases where the Assessing Officer had allowed only a part thereof as bad, in the subsequent year of recovery, the tax liability under this section must be on the amount of difference between the amount recovered and the bad debt disallowed by the Assessing Officer.
(v) **Withdrawal of any amount from special reserve:** Where a deduction has been allowed in respect of any special reserve created and maintained under clauses (viii) of Sub-section (1) of Section 36 any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income tax as the income of the previous year in which such amount is withdrawn.

Where any amount is withdrawn from the special reserve in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

(vi) **Set off of Losses of a Defunct Business against Deemed Profit:** Where the business or profession referred to in this section is no longer in existence and there is income chargeable to tax under points (i), (ii), (iv) and (v) given above in respect of that business or profession, any loss, not being a loss sustained in speculation business, which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall as far as may be, be set off against the income chargeable to tax under the sub-section aforesaid.

**Note:** All that condition needed under Section 41(1) of Income Tax Act is while making assessment, deduction has been allowed and it is not necessary that such assessment with result in positive income. [CIT v. Chaudhary Cotton Ginning and Pressing Factory (2004) 271 ITR 17 (Punj. & Har.).]

### 5.23 SPECIAL PROVISION FOR DEDUCTIONS IN THE CASE OF BUSINESS FOR PROSPECTING ETC. FOR MINERAL OIL (SECTION 42)

For the purpose of computing the profits and gains of any business of prospecting for or the extraction or production of mineral oils in relation to which the Central Government has entered into an agreement with any person for the association or participation in such business of the Central Government, the assessee is entitled to an allowance over and above the various items of allowances and deductions permissible under the Income-tax Act. The additional allowance in this regard would be in relation to the expenditure incurred by the assessee by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee. Where the expenditure is incurred after the beginning of commercial production, the special allowance would relate to the expenditure incurred by the assessee, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection [except those assets which qualify for depreciation allowance under Section 32 only in those cases where the agreement is entered into before 31st Day of March, 1981]. Further, expenditure incurred in relation to the depletion of mineral oil in the mining area in respect of assessment year relevant to the accounting year in which commercial production is begun and such succeeding year as may be specified in the agreement between the Central Government and the assessee would also qualify for this allowance. The amount of this special allowance must be computed in the manner specified in the agreement and wherever necessary the other provisions of the Income-tax Act would, for this purpose, be deemed to have been modified to the extent necessary for giving
effect to the terms of the agreement. For the purposes of this section, ‘mineral oil’, includes petroleum and natural gas.

Section 42 has been amended, with effect from the assessment year 1999-2000 to provide that subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, and the proceeds of the transfer are less than the expenditure incurred remaining unallowed, a deduction equal to the expenditure remaining unallowed as reduced by the proceeds of transfer, shall be allowed in respect of the previous year, in which the business or an interest therein has been transferred. Where such business or any interest therein is transferred and proceeds of the transfer exceed the amount of expenditure incurred remaining unallowed, the excess amount shall be chargeable to tax as profits and gains of business in the previous year in which such business or interest therein has been transferred. No deduction shall be allowed in the previous year in which the business or any interest therein is transferred in case the proceeds of transfer are not less than the expenditure remaining unallowed.

Where in a scheme of amalgamation or demerger, the amalgamating or the demerged company sells or otherwise transfers the business to the amalgamated or the resulting company (being an Indian company) the provisions of this sub-section shall not apply to amalgamating or demerged company. Instead they will apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the latter had not transferred the business or interest in the business.

5.24 SPECIAL PROVISIONS CONSEQUENTIAL TO THE CHANGES IN THE RATE OF EXCHANGE OF CURRENCY

Section 43A of the Income-tax Act contains special provisions to provide for additional allowance to the assessee in respect of capital assets whose actual cost is affected by the changes in the rate of exchange of currency. These provisions are to be taken into account in all cases where an assessee has acquired any depreciable asset from any country outside India for the purposes of his business or profession and as a result of a change in the rate of exchange at any time subsequent to the date of its acquisition by the assessee, there is an increase or reduction in the liability of the assessee in terms of Indian Rupees for making payment towards the whole or part of the cost of the asset or for payment of the whole or part of the moneys borrowed by him from any person directly or indirectly in any foreign currency specifically for the purpose of acquiring the capital asset. The amount by which the liability of the assessee in terms of Indian Rupees is increased or reduced as a result of change in the rate of exchange of the currency, would be added to or as the case may be deducted from the actual cost of the asset as defined in Section 43(1). Consequently, the amounts of depreciation allowable to assessee in respect of the asset would correspondingly be increased or reduced, as the case may be. This provision for changes in the rate of exchange of currency resulting in the increase or reduction in the deduction allowable in respect of actual cost of the asset would apply in respect of capital expenditure on scientific research, capital expenditure incurred for acquisition of patents and copyrights, capital expenditure incurred by companies for promoting family planning amongst their employees and capital expenditure
incurred for acquiring a capital asset, the cost of which under Section 48 has to be ascertained for the purpose of determining the amount of capital gains. The assessee would not, however, be entitled to any increase or reduction in the amount of development rebate allowed or allowable to him on the basis of the revised actual cost of the asset.

For these purposes, the expression ‘rate of exchange’ must be taken to mean the rate of exchange determined or recognised by the Central Government for the conversion of Indian Rupee into foreign currency or vice-versa. In cases where the whole or part of the liability in respect of the payment for the cost of the asset or in respect of the money borrowed from a foreign source for acquiring the capital asset is met not by the assessee but directly or indirectly by any other person or authority, the liability so met by the other persons should not be taken into account for the purposes of any adjustment in the actual cost of the asset and consequently the depreciation allowable to the assessee arising from the change in the rate of exchange of the currency. If, at the time of change in the rate of exchange arising on account of devaluation or otherwise the actual cost of the asset has been fully paid by the assessee and no money remains outstanding in respect of any sum borrowed specifically for the purpose, no adjustment would be permissible to the assessee. The special provision would, however, apply only in respect of capital expenditure or the value of the capital asset and would not in any way affect the value of the current assets, such as stock-in-trade or other trading assets.

Section 43A of the Income-tax Act, 1961 has been amended by the Finance Act, 2002, w.e.f. Assessment Year 2003-04, providing that where a capital asset has been acquired from a foreign country, the addition or deduction from the actual cost of the asset on account of change in the rate of exchange in any previous year shall be allowed to be made only on actual payment by the assessee towards the cost of the asset or repayment of the foreign loan or interest, irrespective of the method of accounting adopted by him.

But, where an addition to or deduction from the actual cost or expenditure or cost of acquisition has been made under this section, under old provision, on account of an increase or reduction in the liability as aforesaid, the amount to be added to, or, as the case may be, deducted under this section from, the actual cost or expenditure or cost of acquisition at the time of making the payment shall be so adjusted that the total amount added to, or, as the case may be, deducted from, the actual cost or expenditure or cost of acquisition, is equal to the increase or reduction in the aforesaid liability taken into account at the time of making payment.

5.25 SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION OF CERTAIN ASSETS (SECTION 43C)

Where an asset [other than those referred to in Section 45(2)] which becomes the property of an amalgamated company under a scheme of amalgamation, is sold after February 29, 1988 as stock in trade the cost of acquisition of the asset to the amalgamated company shall be the cost of acquisition of the asset to the amalgamating company as increased by the cost, if any, of any improvement made thereto and the expenditure if any, incurred wholly and exclusively in connection with such transfer.
Where an asset [other than those referred to in Section 45(2)] which becomes the property of the assessee on the total or partial partition of a HUF or under a gift or will or an irrevocable trust is sold after February 29, 1988, as stock in trade, then, in computing the profits and gains from sale of such assets, the cost of acquisition of the said asset to the assessee shall be the cost of acquisition of the said asset to the transferor or the donor, as the case may be, as increased by the cost, if any, incurred wholly and exclusively in connection with such transfer, including the payment of gift-tax, if any, incurred by the transferor or the donor, as the case may be.

5.26 SPECIAL PROVISION IN CASE OF INCOME OF PUBLIC FINANCIAL INSTITUTIONS, ETC. (SECTION 43D)

Section 43D has been inserted by Finance (No. 2) Act, 1991 w.e.f. 1.4.1991. This section provides that in the case of a public financial institution or a scheduled bank or a state financial corporation or a state industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts shall be chargeable to tax in the previous year in which it is credited to profit and loss account by such institution referred above for that year or in the previous year in which it is actually received by them whichever is earlier.

With a view to improve the viability of leasing finance companies, the section has been amended to provide that in case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such债务 shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous year in which it is actually received by it, whichever is earlier.

5.27 INSURANCE BUSINESS

The profits and gains of any business of insurance must, according to Section 44, be computed in accordance with the rules contained in the First Schedule to the Income-tax Act. For the purpose of the computation, it is immaterial whether the insurance business is carried on by mutual insurance company or by a co-operative society or by any other person. The rules contained in the Schedule would apply notwithstanding anything to the contrary contained in the provisions of the Income-tax Act relating to the computation of income chargeable under the head 'Interest on Securities', 'Income from house property', 'Capital gains', or 'Income from other sources' or under the head 'Income from business or profession'.

5.28 SPECIAL PROVISIONS FOR DEDUCTION IN CASE OF TRADE, PROFESSIONAL OR SIMILAR ASSOCIATIONS

Section 44A of the Income-tax Act provides for a special deduction in the case of any trade, professional or similar association which is not exempt from Income-tax under Section 10(23A). This deduction is allowable in cases where the amount received during the accounting year by the trade, professional or other associations from its members, whether by way of subscription or otherwise, falls short of the expenditure actually incurred by such association during that accounting year solely
for the purpose of protection or advancement of the common interest of the members. Moneys received by way of remuneration for running any specific services to the members would not, however, be treated as forming part of income of the association for this purpose. Consequently, in calculating the amount of deficiency, these receipts would be taken into account and would be allowed as deduction so as to reduce the amount of deficiency. Similarly, capital expenditure and also expenditure deductible in computing the income of the assessee under any other provision of the Act, would not be taken into account in determining the amount of deficiency. The amount of deficiency would be allowable as a deduction in computing the income of the association assessable for the relevant assessment year under the head ‘profits and gains from business or profession’. If there is no income assessable under this head or the amount of deficiency allowable to the assessee exceeds the income under this head, the whole or the balance of the amount of deficiency, as the case may be, shall be allowed as a deduction in computing the income of the association assessable for that assessment year under any other head. The amount of deficiency shall not, however, be allowed to be carried forward for any subsequent year.

The amount of deficiency to be allowed as deduction under Section 44A should not, in any case, exceed 50% of the total income of the association computed before making any allowance under this section. This section, however, applies only to that trade, professional or other similar associations, the income of which or any part thereof is not distributed to its members except as grants to any institution or association affiliated to it. In computing the income of the association for the relevant assessment year in which the deficiency falls allowable, the other provisions of the Act granting deductions and allowances must be given effect to before the deficiency under this section could be allowed. Likewise, losses from any earlier year which are brought forward and qualify for being set off, must be allowed to be set off before the deficiency under this section is sought to be allowed as deduction.

5.29 MAINTENANCE OF ACCOUNTS (SECTION 44AA)

The following persons are liable to maintain such books of accounts and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act:

(i) Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board [i.e. authorised representative or film artist].

(ii) Every person who is carrying on business or profession [not being profession referred to in point (i) above] and whose income from business or profession exceeds ₹ 1,20,000 or the total sales, turnover or gross receipts exceeds ₹10,00,000 in any one of the three years immediately preceding the previous year.

(iii) In case of a newly set up business or profession in the previous year, if his income from business or profession is likely to exceed ₹ 1,20,000 or total sales, turnover or gross receipts are likely to exceed ₹ 10,00,000, during such previous year.
(iv) Where profits and gains from business are deemed to be profits and gains under section 44AE or Section 44BB or Section 44BBB and assessee has claimed his income to be lower than the profits and gains then such profits and gains shall be deemed to be profits and gains of his business during the previous year or

(v) where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax during such previous year.

Under presumptive assessment under sections mentioned above, if assessee claims that his income is lower than that specified under these sections, assessee is required to gets his accounts audited by a Chartered Accountant and copy of that report needs to be attached alongwith his return of income. Therefore to gets his accounts audited he needs to maintain such books to substantiate his claim and also to enable Chartered Accountant to issue Audit Report to this effect.

For details students may refer to Rule 6F also for specified books to be maintained.

5.30 COMPULSORY AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION

Section 44AB makes it obligatory for

1. a person to get his accounts audited before the 'specified date' by an 'accountant' if the total sales, turnover or gross receipts in business for the previous year exceed or exceeds ₹60 lakhs Or

2. a person carrying on profession will also have to get his accounts audited before the specified date, if his gross receipts in profession for a previous year or years relevant to any of the aforesaid assessment years exceed ₹15 lakhs.

The provision also casts an obligation on such persons to furnish by the 'specified date' a report of the audit in the prescribed form duly signed and verified by the accountant setting forth such particulars as may be prescribed by rules made in this behalf by the Central Board of Direct Taxes. In cases where accounts are required to be audited by or under any other law, it will suffice if the accounts are audited under such other law before the specified date and the assessee furnishes by that the said date the report of the audit as required under such other law.

Where profits and gains from business are deemed to be profits and gains under or section 44AE or Section 44BB or Section 44BBB as the case may be and assessee has claimed his income to be lower than the profits and gains then such profits and gains shall be deemed to be profits and gains of his business during the previous year or

Assessee carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to
be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year.

Under presumptive assessment under sections mentioned above, if assessee claims that his income is lower than that specified under these sections, assessee is required to get his accounts audited by a Chartered Accountant and copy of that report needs to be attached along with his return of income. Therefore to get his accounts audited he needs to maintain such books to substantiate his claim and also to enable Chartered Accountant to issue Audit Report to this effect.

However, as amended by the Finance Act, 1992, the provision of this section of compulsory audit shall not apply to those assesses who derive income under Section 44BBA on and from April 1, 1985 or, as the case may be, the date on which the relevant section came into force, whichever is later.

The term ‘accountant’ will have the same meaning as in the explanation to Sub-section (2) of Section 288 of the Income-tax Act and the term ‘Specified date’, in relation to the accounts of the assessee of the previous year relevant to an assessment year means the 31st day of October of the assessment year.

According to Section 271B, if any person fails without reasonable cause to get his accounts audited in respect of any previous year or years relevant to an assessment year or to furnish a report of such audit as required under the aforesaid provision, or furnish the said report along with the return of his income, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum equal to 1/2% of total sales, turnover or gross receipts, as the case may be, in the business, or the gross receipts in the profession of such previous year or years, subject to a maximum of ₹ 1.5 lakh.

5.31 SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESumptIVE BASIS (SECTION 44AD)

The provisions of this section shall be applicable on any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE; and whose total turnover or gross receipts in the previous year does not exceed an amount of sixty lakh rupees. This section inserted by Finance Act, 2009 for providing relief to all the small businesses from the maintaining the books of accounts and to reduce the compliance and administrative burden.

1. This section will cover an individual, Hindu undivided family or a partnership firm, other than Limited Liability Partnership firm and who has not claimed deduction under any of the sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA.

2. A sum equal to eight per cent of the total turnover or gross receipts of the assessee in the previous year shall be deemed to be the profits and gains of such business chargeable to tax under the head ‘Profits and gains of business or profession further the assessee have the option to claim a sum higher than eight per cent of the total turnover or gross receipts.

3. No deduction shall be allowed to the assessee under sections 30 to 38 however the salary and interest paid to the partners shall be allowed for deduction subject to the conditions and limits specified in section 40(b)
4. The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

5. Where the assessee claims that his profits and gains from the business are lower than the profits and gains on presumptive basis and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under section 44AA and get them audited and furnish a report of such audit as required under section 44AB.

It means that section 44AA and 44AB shall be applicable only if assessee does not opt for presumptive taxation and his total income exceeds the taxable limit.

5.32 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES (SECTION 44AE)

Section 44AE provides for a system for estimating the income of an assessee engaged in the business of plying, hiring or leasing of goods carriages. The scheme is applicable to an assessee who owns not more than ten goods carriages at any time during the previous year and who is engaged in the business of plying, hiring or leasing of such goods carriages. The profits and gains of each goods carriage shall be estimated as under:

(i) ₹5,000 for every month or part of a month in case of a heavy goods vehicle;

(ii) ₹4,500 for every month or part of a month in case of other goods vehicle.

The assessee may however declare a higher income.

Any deduction allowable under the provisions of Sections 30 to 38 shall, for the purposes of the above income, be deemed to have been already given full effect to and no further deduction under these sections shall be allowed.

Remuneration and interest paid/payable to partners, shall be allowed as deduction from the income computed under this Section. Such deduction shall however be subject to the conditions and limits specified under Section 40(b).

The written down value of any asset used for the purpose of the business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment year.

The assessee is neither required to maintain books of accounts under the provisions of Section 44AA, nor required to get his accounts audited under the provisions of Section 44AB in respect of his income from such business. However, for other business (if any) he will have to comply with the Sections 44AA and 44AB.

Income from such business as estimated will be aggregated with other incomes of the assessee from other businesses or other heads of income and all deductions under Sections 80CCC to 80U will be available to the assessee on fulfillment of the
requisite conditions of those sections.

If the assessee claims and produces evidence to prove that profits and gains from such business during assessment year 1997-98 or earlier years is lower than the estimate of profits as per this section, the Assessing Officer shall make assessment of such income under Section 143(3) and determine the sum payable by the assessee on the basis of such assessment.

With effect from assessment year 1998-99 the section has been amended to provide that an assessee can claim his income to be lower than the estimate as per this section. However, in that case he will have to keep books of accounts and other documents as per Section 44AA and will have to get his accounts audited irrespective of the turnover under Section 44AB.

5.33 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF SHIPPING BUSINESS IN THE CASE OF NON-RESIDENTS (SECTION 44B)

In the case of a non-resident assessee, engaged in the business of operation of ships, a sum equal to 7-1/2% of the aggregate of the following amounts shall be deemed to be the profits and gains of such business chargeable to tax under the head ‘Profits and gains of business or profession’:

(i) The amount paid or payable (in India or outside) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) The amount received or deemed to be received in India, by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

5.34 SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS IN CONNECTION WITH THE BUSINESS OF EXPLORATION ETC., OF MINERAL OILS (SECTION 44BB)

(1) Notwithstanding anything to the contrary contained in Sections 28 to 41 and Sections 43 and 43A, in the case of an assessee being a non-resident engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils, a sum equal to ten per cent of the aggregate of the amounts specified in Sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

Provided that Section 44BB(1) shall not apply in a case where provisions of Section 42 or Section 44D or section 44DA or Section 115A or Section 293A apply for the purposes of computing profits or gains or any other income referred to in those sections.

(2) The amounts referred to in Sub-section (1) shall be the following, namely:

(i) the amount paid or payable (whether in India or outside) to the assessee or to any person on his behalf on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire
used or to be used in the prospecting for, or extraction or production of
mineral oil in India; and

(ii) the amount received or deemed to be received in India, by or on behalf
of the assessee on account of the provision of services and facilities in
connection with, or supply of plant and machinery on hire used or to be
used in the prospecting for, or extraction or production of, mineral oils
outside India.

(3) Notwithstanding anything contained in Sub-section (1), an assessee may
claim lower profits and gains than the profits and gains specified in that Sub-section,
if he keeps and maintains such books of account and other documents as required
under Sub-section (2) of Section 44AA and gets his accounts audited and furnishes a
report of such audit as required under Section 44AB, and thereupon the Assessing
Officer shall proceed to make an assessment of the total income or loss of the
assessee under Sub-section (3) of Section 143 and determine the sum payable by, or
refundable to, the assessee.”

Explanation: For the purposes of this section—
(i) “plant” includes ships, aircraft vehicles, drilling units, scientific apparatus and
equipment, used for the purposes of the said business;
(ii) “mineral oil” includes petroleum and natural gas.

5.35 SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF THE
BUSINESS OF OPERATION OF AIRCRAFT IN THE CASE OF NON-
RESIDENTS (SECTION 44BBA)

(1) Notwithstanding anything to the contrary contained in Sections 28 to 43A, in
the case of an assessee, being a non-resident, engaged in the business of operation
of aircraft, a sum equal to five per cent of the aggregate of the amounts specified in
Sub-section (2) shall be deemed to be the profits and gains of such business
chargeable to tax under the head —Profits and gains of business or profession”.

(2) The amounts referred to in Sub-section (1) shall be the following, namely:

(i) the amount paid or payable (whether in or out of India) to the assessee or to
any person on his behalf on account of the carriage of passengers, livestock,
mail or goods from any place in India; and

(ii) the amount received or deemed to be received in India, by or on behalf of the
assessee on account of the carriage of passengers, livestock, mail or goods
from any place outside India.

5.36 SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF
FOREIGN COMPANIES ENGAGED IN THE BUSINESS OF CIVIL
CONSTRUCTION ETC. IN CERTAIN TURNKEY POWER PROJECTS
[SECTION 44BBB]

(1) Where a foreign company is engaged in the business of civil construction or
the business of erection of plant or machinery or testing or commissioning thereof, in
connection with a turnkey power project approved by the Central Government and
financed under any international aid programme, ten per cent of the amount paid or payable, whether in or out of India, to the said assessee or any person on his behalf on account of such assignment shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

(2) Notwithstanding anything contained in Sub-section (1), an assessee may claim lower profits and gains than the profits and gains specified in that Sub-section, if he keeps and maintains such books of account and other documents as required under Sub-section (2) of Section 44AA and gets his accounts audited and furnishes a report of such audit as required under Section 44AB, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee under Sub-section (3) of Section 143 and determine the sum payable by, or refundable to, the assessee.

5.37 DEDUCTION OF HEAD OFFICE EXPENDITURE IN THE CASE OF NON-RESIDENTS (SECTION 44C)

A non-resident shall be allowed expenditure in the nature of head office expenditure to the extent of least of:

(a) an amount equal to 5% of the adjusted total income; or

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

Where the adjusted total income of the assessee is a loss, the amount shall be computed at the rate of 5% of the average adjusted total income of the assessee.

Adjusted total income means, the total income computed under the provisions of this Act but without giving effect to the following:

(i) allowance referred to in this section;
(ii) unabsorbed depreciation [Section 32(2)];
(iii) investment allowance [Section 32A];
(iv) development rebate [Section 33];
(v) development allowance [Section 33A];
(vi) family planning expenses incurred by a company [Section 36(1)(ix)];
(vii) carried forward business loss [Section 72(1)];
(viii) carried forward speculation loss [Section 73(2)];
(ix) carried forward capital loss [Section 74(1) and (3)];
(x) carried forward loss from horse race [Section 74A(3)];
(xi) deductions from gross total income under Chapter VIA [i.e. under Sections 80C to 80U].

‘Average adjusted total income’ means the average total income of the assessee of the three assessment years immediately preceding the relevant assessment year or for lesser period if the assessee is assessable for that period, as the case may be.
Head office expenditure’ means executive and general administration expenditure incurred by the assessee outside India including expenditure incurred in respect of:

(i) rent, rates, taxes, repairs, insurance of any premises outside India used for the purpose of business or profession;

(ii) salaries, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary paid or allowed to any employee or other persons employed in, or managing the affairs of any office outside India;

(iii) travelling expenses of the person mentioned in (ii); and

(iv) such other matters connected with executive and general administration as may be prescribed.

5.38 COMPUTATION OF INCOME BY WAY OF ROYALTY ETC. IN CASE OF FOREIGN COMPANIES (SECTION 44DA)

In case of a foreign company, the deduction admissible in computing the income by way of royalty or fees for technical service received from government or an Indian concern in pursuance of an agreement made by it with the government or an Indian concern before 1.4.1976 shall not exceed in the aggregate 20% of the gross amount of such royalty or fees as reduced by so much of the gross amount of such royalty as consists of lump sum consideration for the transfer outside India or the imparting of information outside India in respect of any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property. However, no deduction under any of the sections (Sections 28 to 44C) shall be allowed in computing the income by way of royalty or fees for technical services received from government or an Indian concern in pursuance of an agreement made by the foreign company with the Indian concern after 31.3.1976 but before the 1st day of April, 2003.

No deduction in respect of any expenditure or allowance shall be allowed under any of the said sections (Sections 28 to 44C) in computing income by way of interest received from Government or an Indian concern on moneys borrowed or debt incurred by the Government or the Indian concern in foreign currency.

Further the provisions of section 44BB shall not apply in respect of the income referred to in this section.

Illustration:

Advise an assessee about the admissibility or otherwise of the claims, with regard to the following items, giving reasons:

(a) Compensation paid to an employee for premature termination of his services.

(b) Amount spent in a successful suit filed against another for infringing the assessee’s trademark.

(c) Penalty paid to customs authorities for importing prohibited goods which yielded a large margin of profits.

(d) Travelling expenses of a director who went to Europe for negotiating the
purchase of a new heavy machinery which was eventually installed next year.

(e) Cost of erecting a medical annexe to the factory for the emergency treatment of the employees.

(f) Lump-sum consideration paid for acquiring know-how ₹ 6,00,000.

(g) Loss of ₹ 1,000 which were snatched away from the khazanchee’s possession while going to bank to deposit the amount.

(h) Loss due to embezzlement by an employee.

(i) Brokerage paid for raising loan for the business.

(j) ₹ 1,000 spent in connection with installation of a new telephone connection.

(k) Fees paid to lawyer for drafting the Deed of Agreement with an outsider relating to the setting-up the business.

(l) Pension paid to the widow and children of a deceased engineer of the factory voluntarily.

(m) Interest paid for funds borrowed specifically for the acquisition of a capital asset.

**Solution:**

(a) Assuming that the termination of the services of an employee was in the interest of the business, this item will be treated as an admissible expenditure.

(b) It is admissible as the expenditure has been incurred to maintain an asset (viz., the trademark).

(c) Penalty paid for illegal activities of the assessee are not to be allowed as expenditure under the Income Tax Act.

(d) It is inadmissible as it is incurred for the acquisition of a new asset.

(e) It is not an admissible expenditure, being of a capital nature. However, depreciation can be claimed u/s 32(1).

(f) On the cost of know-how depreciation shall be allowed @ 25% on W.D.V. basis u/s 32(1).

(g) This loss is admissible as it was part of his duty to carry cash for depositing it in bank and hence it is incidental to the business.

(h) It is admissible as it has been sustained during the ordinary course of business.

(i) Brokerage paid for raising a loan for the business is an admissible expenditure.

(j) It is an admissible deduction under executive instruction.

(k) It is not admissible as it is in the nature of capital expenditure, but 1/5th of it will be allowed under Section 35D for five successive previous years.

(l) Pension paid to the widow and children of a deceased engineer is not allowed as deduction as it is not an obligatory expenditure in connection with the business.

(m) Interest paid for funds borrowed specifically for the acquisition of a capital asset is allowable u/s 36(1)(iii) as it is incurred for the purpose of the business.
Illustration:

From the following Profit and Loss Account of a Merchant for the year ending 31st March, 2012. Compute his income from business and his total income for assessment year 2012-13:

<table>
<thead>
<tr>
<th>Profit and Loss Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>₹</td>
</tr>
<tr>
<td>To Trade expenses 700</td>
</tr>
<tr>
<td>By Gross Profit 35,200</td>
</tr>
<tr>
<td>To Salary 2,500</td>
</tr>
<tr>
<td>By Dividend from a</td>
</tr>
<tr>
<td>To Rent, Rates and Taxes 2,400</td>
</tr>
<tr>
<td>By Cooperative Society 3,000</td>
</tr>
<tr>
<td>To Income-tax 1,400</td>
</tr>
<tr>
<td>By Income from Property 850</td>
</tr>
<tr>
<td>To Discount and allowance 300</td>
</tr>
<tr>
<td>By Interest from Government</td>
</tr>
<tr>
<td>To Household expenses 2,000</td>
</tr>
<tr>
<td>By Securities (gross) 2,000</td>
</tr>
<tr>
<td>To Life Insurance Premium 1,000</td>
</tr>
<tr>
<td>To Interest on Capital 500</td>
</tr>
<tr>
<td>To Interest on loan 700</td>
</tr>
<tr>
<td>To Advertisement 800</td>
</tr>
<tr>
<td>To Postage and Telegram 50</td>
</tr>
<tr>
<td>To Audit Fee 200</td>
</tr>
<tr>
<td>To Provision for gratuity 4,000</td>
</tr>
<tr>
<td>To Fire Insurance Premium 730</td>
</tr>
<tr>
<td>To Provision for bad debts 2,000</td>
</tr>
<tr>
<td>To Provision for Income-tax 1,800</td>
</tr>
<tr>
<td>To Depreciation 4,000</td>
</tr>
<tr>
<td>To Net Profit 15,970</td>
</tr>
<tr>
<td>41,050</td>
</tr>
</tbody>
</table>

Solution:

Calculation of Taxable Profits from Business

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Add: Inadmissible items:</td>
</tr>
<tr>
<td>— Income tax 1,400</td>
</tr>
<tr>
<td>— Household Expenses 2,000</td>
</tr>
<tr>
<td>— Life Insurance Premium 1,000</td>
</tr>
<tr>
<td>— Interest on Capital 500</td>
</tr>
<tr>
<td>— Provision for gratuity 4,000</td>
</tr>
<tr>
<td>— Provision for bad debts 2,000</td>
</tr>
<tr>
<td>— Provision for Income-tax 1,800</td>
</tr>
<tr>
<td>12,700</td>
</tr>
</tbody>
</table>

28,670
Less: Income to be shown separately:

— Dividends from a cooperative society 3,000
— Income from property 850
— Interest from Government Securities 2,000 (5,850)

Taxable Profits from Business 22,820

Calculation of Income from house property:

Income from property 850
Less: 30% under Section 24 (255)
Income from house property 595

Calculation of Income from other sources:

Dividends from cooperative society 3,000
Interest from Government Securities 2,000
Income from other sources 5,000

Calculation of Gross Total Income:

Income from house property 595
Income from Business 22,820
Income from other sources 5,000
28,415

Notes:

1. Provision for gratuity is not admissible. However, payment of actual gratuity is allowed.

2. It is assumed that income from property is by way of rent received and as per the provision of Section 24 of the Act, thirty percent thereof has been deducted as repair allowance.

Illustration:

Following particulars are supplied by a textile unit situated in Mumbai for the assessment year 2012-13:

<table>
<thead>
<tr>
<th>Block of Assets</th>
<th>WDV as on 1.4.2011</th>
<th>Additions</th>
<th>Sale</th>
<th>Rate of Dep.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factory building</td>
<td>20,50,000</td>
<td>8,00,000</td>
<td>—</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(completed on 15.1.2012)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential buildings</td>
<td>50,00,000</td>
<td>5,00,000</td>
<td>—</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(completed on 31.7.2011)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plant and Machinery</td>
<td>90,00,000</td>
<td>3,00,000</td>
<td>11,00,000</td>
<td>15%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(on 5.10.2011)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Furniture and fittings</td>
<td>10,30,000</td>
<td>1,00,000</td>
<td>3,50,000</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(on 10.10.2011)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
You are required to calculate the amount of allowable depreciation under the Income-tax Act, 1961.

Solution:

**Computation of Depreciation**

<table>
<thead>
<tr>
<th></th>
<th>₹</th>
<th>@</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Factory Building</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WDV as on 01.04.2011</td>
<td>20,50,000</td>
<td>10%</td>
<td>2,05,000</td>
</tr>
<tr>
<td>Addition on 15.01.2012</td>
<td>8,00,000</td>
<td>50% of 10%</td>
<td>40,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2,45,000</td>
</tr>
<tr>
<td><strong>Residential Building</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WDV as on 1.4.2011</td>
<td>50,00,000</td>
<td>5%</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Addition as on 31.7.2011</td>
<td>5,00,000</td>
<td>5%</td>
<td>25,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2,75,000</td>
</tr>
<tr>
<td><strong>Plant and Machinery</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WDV as on 1.4.2011</td>
<td>90,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Sale</td>
<td>(11,00,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>79,00,000</td>
<td>15%</td>
<td>11,85,000</td>
</tr>
<tr>
<td>Addition as on 5.10.2011</td>
<td>3,00,000</td>
<td>50% of 15%</td>
<td>22,500</td>
</tr>
<tr>
<td>Additional depreciation on new investment</td>
<td>20% of 3,00,000</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>12,67,500</td>
</tr>
<tr>
<td><strong>Furniture</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WDV as on 1.4.2011</td>
<td>10,30,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Sale</td>
<td>(3,50,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>6,80,000</td>
<td>10%</td>
<td>68,000</td>
</tr>
<tr>
<td>Addition as on 10.10.2011</td>
<td>1,00,000</td>
<td>50% of 10%</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>73,000</td>
</tr>
</tbody>
</table>

**Note:** In the case of assets which are put to use in the business for a period of less than 180 days, the depreciation permissible is @ 50% of the normal rate.

**Illustration:**

Net profit as per profit and loss account of X is ₹ 6,86,000 for the year ending 31st March, 2012. The following information is noted from his accounts:

(a) Advertisement expenditure debited to profit and loss account include the following:

(i) Expenditure incurred outside India: ₹ 46,000 (permitted by RBI);

(ii) Articles presented by way of advertisement (60 articles cost of each
being ₹ 900; and 36 articles cost of each being ₹ 1,700);
(iii) ₹ 16,000 being cost of advertisement which appeared in a newspaper owned by a political party;
(iv) ₹ 11,400 being capital expenditure on advertisement;
(v) ₹ 12,000 paid in cash; and
(vi) ₹ 7,000 paid to a concern in which X has substantial interest (amount is excessive to the extent of ₹ 1,400).

(b) Out of salary to employees of ₹ 8,70,000 debited to the profit and loss account:

(i) ₹ 40,000 is employees' contribution to recognised provident fund, ₹ 37,500 of which is credited in the employees' account in the relevant fund before the 'due date';
(ii) ₹ 46,000 is bonus which is paid on 13th November, 2011;
(iii) ₹ 36,000 is commission which is paid on 1st December, 2012;
(iv) ₹ 20,000 is incentive to workers which is paid on 10th December, 2012;
(v) ₹ 40,000 is paid outside India in respect of which tax is not deducted at source;
(vi) ₹ 6,000 being capital expenditure for promoting family planning amongst employees; and
(vii) ₹ 40,000 being entertainment allowance given to employees.

(c) Entertainment expenditure debited to profit and loss account is ₹ 9,000.

Determine the net income of X for the assessment year 2012-13.

Solution:

Calculation of Net Income of X for assessment year 2012-13

₹

Net Profit as per Profit and Loss Account 6,86,000

Add: Inadmissible items:

Cost of advertisement which appeared in a newspaper owned by a political party 16,000
Excessive amount paid to a concern in which X has substantial interest 1,400

Employee contribution to recognised provident fund (to the extent not credited in the employees' account in the relevant fund before the 'due date') 2,500

Bonus being paid to employees after the 'due date' of filing the return 46,000
Commission being paid to employees after the 'due date' of filing the return 36,000
Salary paid outside India in respect of which tax is not deducted at source 40,000
Capital expenditure for promoting family planning amongst employees (allowed only to a corporate assessee) 6,000
Capital expenditure on Advertisements 11,400 1,59,300
Net Income 8,45,300

Notes:
1. Restrictions on advertisement and entertainment abolished.
2. With the abolition of Section 37(3), which inter alia governed the deductibility of advertising expenses, advertising too has come within the fold of the omnibus Section 37(1) which specifically frowns on capital expenditure. The Himachal Pradesh High Court verdict in Mohan Meakin Breweries Ltd. v. CIT (1979) 118 ITR 101 allowing capital expenditure on advertising therefore has ceased to have the force of law as it was rendered in the context of Section 37(3).
3. Advertisement expenses of `12,000 (i.e. within the limit of `20,000) is paid in cash, hence admissible.
4. The due date for filing return where the assessee is a person (other than a company) who is required to get his accounts audited under the Income-tax Act or any other law is September 30; and where the assessee is a person deriving income from business and who is not required to get his accounts audited, the due date is July, 31.

Under the provisions of Section 43B of the Act - Bonus `46,000 paid on 13th Nov., 2011 and Commission `36,000 paid on 1st Dec., 2012 are not admissible since the payments are made after the above mentioned due date.
5. Incentive to workers which is paid on 10th December, 2012 is admissible on due basis.

PART IV : INCOME FROM CAPITAL GAINS

5.39 CAPITAL GAINS

Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head "Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place.

Doubts may arise as to whether Capital Gains being a capital receipt can be brought to tax as income. It may be noted that the ordinary accounting canons of distinctions between a capital receipt and a revenue receipt are not always followed under the Income-tax Act. Section 2(24)(vi) of the Income-tax Act specifically
provides that "Income" includes "any capital gains chargeable under Section 45(1)". It may not be out of place to mention here that in the absence of a specific provision in Section 2(24) capital gains have no logic to be taxed as income. The constitutional validity of the provisions of the Act relating to capital gains was challenged in *Navin Chandra Mafatlal v. C.I.T.* (1955) 27 ITR 245. The Supreme Court while upholding the competence of parliament in legislating with regard to capital gains as part of income, observed that the term income should be given the widest connotation so as to include capital gains within its scope. However, all capital profits do not necessarily constitute capital gains. For instance, profits on re-issue of forfeited shares, profits on redemption of debentures, premium on issue of shares, 'pagri' from tenants etc. are capital profits and not capital gains, hence, not liable to tax.

The requisites of a charge to income-tax, of capital gains under Section 45(1) are:

(i) There must be a capital asset.
(ii) The capital asset must have been transferred.
(iii) The transfer must have been effected in the previous year.
(iv) There must be a gain arising on such transfer of a capital asset. These requisites are briefly analysed below:
(v) Such capital gain should not be exempt under Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, or 54GA

5.40 CAPITAL ASSET

Unless the gain is relatable to a capital asset there can be no charge to capital gains tax. Section 2(14) of the Income-tax Act defines the term "capital asset" to mean:

Property of any kind held by an assessee whether or not connected with his business or profession but does not include

(i) any stock-in-trade, consumable stores or raw-materials held for the purposes of his business or profession;

(ii) personal effects that is to say, movable property (including wearing apparel and furniture but excluding jewellery) held for personal use by the assessee or any member of his family dependent on him. Jewellery includes ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel and precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;

(iii) agricultural land in India, not being land situate (a) within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000 according to the last preceding census, or (b) in any area within such distance, not being more than eight kilometers from the local limits of any Municipality or cantonment board, as the Central Government may, having regard to the extent of any scope for urbanisation of that area and
other relevant considerations, specify in this behalf by notification in the Official Gazette;

(iv) 6½ per cent Gold Bonds, 1977 or 7 per cent Gold Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government;

(v) special Bearer Bonds 1991 issued by the Central Government.

(vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

The term property appearing in Section 2(14) has not been defined in the Income-tax Act. Even the Transfer of Property Act does not contain any definition of the term. But, the scope of Section 2(14) is very wide. With the exception of the aforementioned assets, all other assets are included in the category of capital asset. "Capital asset" includes movable/immovable asset, tangible/ intangible assets, incorporeal rights and chose-in-action. It would also include share of a partner in a firm, goodwill of a firm, mining rights, industrial licence acquired by consideration, tenancy right or leasehold right, foreign currency, right to subscribe for shares, the contractual right of a purchaser to obtain title to an immovable property, etc. Some of the judicial rulings in this context are as follows:

Property is a term of widest import and subject to any limitation which the context may require, it signifies every possible interest which a person can hold and enjoy - [Ahmed G.H. Arif v. C.W.T. (1970) 76 ITR 471 (SC)].

Even business interest would be brought within the term property [C.I.T. v. Krishna Warrier (1964) 53 ITR 176 (SC)]. Even the business undertaking as a whole would fall within the definition of the term ‘property’ in Section 2(14) of the Act. [R.C. Cooper v. Union of India AIR 1970 (SC) 564]. The Gujarat High Court has rightly summed up as follows: The words ‘property of any kind’, are words of widest amplitude. They exclude any limitation which may be sought to be introduced for the purpose of restricting the applicability of the definition. The adverbial clause ‘whether or not connected with his business or profession” also emphasizes the width and amplitude of the definition. Every kind of property held by an assessee, whatever be its nature or character, is within the connotation of the expression ‘capital asset’ provided, of course, it does not fall within the excepted categories specified in clauses (i) to (vi).

Cost of Self generated Capital Assets: The Madras High Court in C.I.T. v. V.K. Rathnam Nadar (1969) 71 ITR 433 held that capital gain arises only on the transfer of capital asset which had actually cost something to the assessee. Such actual cost in the context of the Income-tax Act being cost in terms of money, it cannot apply to transfer of capital asset which did not cost anything to the assessee in terms of money in its creation or acquisition. In other words, though self generated asset like goodwill is a capital asset in general law, its sale or transfer would not attract tax on capital gains in the hands of the person who has created it by carrying on his business or profession, as the coming into existence or growth of self-created assets does not cost anything in terms of money. The Delhi, Calcutta, Kerala and Karnataka High Courts have taken the same view.

However, with effect from Assessment Year 1988-89, Section 55 is amended to
remove this legal difficulty. It provides that where goodwill is self-generated, the cost of acquisition for computation of capital gain shall be deemed to be nil and where it has been purchased, the cost will be taken to be the actual price paid for it. The cost of improvement also in relation to goodwill be taken to be nil.

The Government has overcome the problem of taxing capital gains on transfer of three other categories of self-generated assets: with effect from the assessment year 1995-96, cost of tenancy rights, route permits and loomhours would also be deemed to be nil.

From Assessment year 2008-09, the scope of Section 2(14) has been indexed with the introduction of taxability provision with regards to ‘personal effects being archeological collections’.

5.41 TRANSFER

The essential requirement for the incidence of tax on capital gains is the transfer of a ‘capital asset’. The term transfer has been defined in Section 2(47) of the Act to include the sale, exchange or relinquishment of the asset, extinguishment of any rights therein or the compulsory acquisition thereof under any law or, in a case where the asset is converted by the owner thereof into, or is treated by him as stock-in-trade of a business carried on by him, such conversion or treatment. Transfer means effective conveyance of legal title to the transferee. In case of immovable property, the title to the property passes to the transferee when the conveyance deed is executed and registered. In the case of movable property, the provisions contained in the Sale of Goods Act would apply.

Also beneficial enjoyment of immovable property is treated as transfer. Thus, any transaction involving the allowing of the possession of any immovable property in part performance of the contract (under Section 53A of the Transfer of Property Act, 1882) is a transfer even though the legal ownership may not have been transferred under the general law of the land. Thus, transfer of immovable property under irrevocable power of attorney will fall in the tax net. Similarly, any transaction which has the effect of transferring or enabling the enjoyment of any immovable property is also a transfer. Such transaction may be by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or it may be by way of agreement or arrangement or in any other manner whatsoever.

Further, the distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons, is also regarded as transfer liable to capital gains tax. For the purposes of computing capital gain in such cases, the fair-market value of the capital asset on the date of such distribution will be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset.

Transactions which do not constitute transfer [Sections 46 and 47]

(i) any distribution of capital assets on the total or partial partition of a Hindu Undivided Family;

(ii) any transfer of a capital asset under a gift or will or an irrevocable trust;

Provided that this clause shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants
allowed by a company directly or indirectly to its employees under the Employees’ Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued by the Central Government in this behalf;

(iii) any transfer of a capital asset by a company to its subsidiary company, if—
   (a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and
   (b) the subsidiary company is an Indian company;

(iv) any transfer of a capital asset by a subsidiary company to the holding company, if —
   (a) the whole of the share capital of the subsidiary company is held by the holding company, and
   (b) the holding company is an Indian company;

(v) any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company;

(vi) any transfer in a scheme of amalgamation of a capital asset being share or shares held in an Indian Company, by the amalgamating foreign company to the amalgamated foreign company, if—
   (a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
   (b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated (applicable from the assessment year 1993-94);

(viaa) any transfer in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under Sub-section (7) of Section 45 of the Banking Regulation Act, 1949, of a capital asset by the banking company to the banking institution.

(vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

(vic) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if—
   (a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
   (b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated provided that the provisions of Sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demerger referred to in this clause.

(vid) any transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.
(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if—
(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
(b) the amalgamated company is an Indian company;
(viiia) any transfer of a capital asset of such foreign currency convertible bonds or Global Depository Receipts as are referred to in Section 115AC(1) held by a non-resident to another non-resident where the transfer is made outside India (applicable from 1.6.1992);
(viii) any transfer of agricultural land in India effected before the first day of March, 1970;
(ix) any transfer of a capital asset being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States;
(x) any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company, into shares or debentures of that company.
(xi) any transfer made on or before 31.12.1998 by a person not being a company of a capital asset being membership of a recognised stock exchange to a company in exchange for shares allotted by that company to him (transferor).
(xii) any transfer of land by a sick industrial company made at any time beginning with declaration of it being sick by the BIFR and ending with the previous year in which its net worth wipes out the accumulated losses.
(xiii) where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital asset or intangible asset to the company:

Any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of the demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company.

Provided that—
(a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company,
(b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital account stood in the books of the firm on the date of succession.
(c) the partners of the firm do not receive any consideration or benefit, directly or indirectly in any form or manner, other than by way of allotment of shares in the company, and
(d) the aggregate of the 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 continue to be as such for a period of five years from the date of succession.

(e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for corporatisation which is approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992.

(xiiia) any transfer of a capital asset being a membership right held by a member of a recognised stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).

(xiiib) any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership

Conditions for claiming exemption

(a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership

(b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion

(c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership

(d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion

(e) the total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees and

(f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.
(xiv) where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company.

Provided that—

(a) all the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession becomes the assets and liabilities of the company;

(b) the shareholding of the sole proprietor in the company is not less than fifty per cent of the total voting power in the company and his shareholding continues to so remain as such for a period of five years from the date of the succession; and

(c) the sole proprietor does not receive any consideration or benefit directly or indirectly in any form or manner, other than by way of allotment of shares in the company.

(xv) any transfer in a scheme for lending of any securities under an agreement or arrangement, which the assessee has entered into with the borrower. Of such securities and which is subject to the guidelines issued by the Securities and Exchange Board of India, established under Section 3 of the Securities and Exchange Board of India Act, 1992 or the Reserve Bank of India in this regard.

(xvi) any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government.

Thus, transfer of capital assets falling in any of the categories discussed above would not attract liability to capital gains tax. The following points should be noted:

The fact that a transfer becomes void under Section 281 of the Act does not in any way preclude levy of capital gains tax. In the case of transfer of shares held as capital asset, the date of transfer is the date of delivery of the share certificates to the transferee and not the date of registration of the shares in the name of the transferee in the register of company. This apart, it is essential that on the date of transfer the asset should have been held as capital asset in order to attract Section 45 of the Act. Further the notional profit arising from transfer by way of conversion of capital asset into stock-in-trade will be chargeable to tax in the year in which stock-in-trade is sold. For the purpose of computing the capital gain in such cases, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade will be deemed to be the full value of consideration receiving or accruing as a result of the transfer of the capital asset.

The following case laws, on the concept of transfer may also be taken note of:

Where the Tribunal held that having regard to the scheme of amalgamation between the assessee and another company, no sum could be assessed in the hands of the assessee as no capital gains had accrued to it by exchange or relinquishment as provided in Section 12B of the 1922 Act, it was held that in view of the decision in CIT v. Rasiklal Maneklal (HUF) [1974] 95 ITR 656 (Bom.) the order of the Tribunal was to be upheld - CIT v. Mafatlal Gagalbhai & Co. (P.) Ltd. [1989] 42 Taxman 26/177 ITR 488 (Bom.).
Where the assessee, who is shareholder of company A and company A was amalgamated with another company B and the assessee received shares of the company B in lieu of the shares of A, neither an ‘exchange’ nor a ‘relinquishment’ takes place and hence no capital gains will be leviable. *CIT v. Rasiklal Maneklal (HUF)* [1989] 43 Taxman 259/177 ITR 198 (SC).

Handing over of capital asset to firm amounts to a transfer, but no capital gains liable to income-tax accrue to assessee thereby — *Ved Parkash Aggarwal v. CIT* (1989) 46 Taxman 31/179 ITR 378 (Punj. and Har.).

Making over of immovable properties by assessee-firm to partners at its book value by making necessary book entries would not amount to transfer of capital asset within the meaning of Section 2(47) and, therefore, would not attract capital gains tax — *CIT v. Bharati Engg. Corp.* [1989] 46 Taxman 80/180 ITR 32 (Punj. & Har.). A new Sub-section (1A) has been inserted in Section 45 by the Finance Act, 1999 w.e.f. 1.4.2000. It provides that where any person receives any money or other assets under an insurance from the insurer on account of damage to or destruction of any capital asset, as a result of flood, typhoon, hurricane, cyclone, earth quake or other convulsion of nature or on account of riot or civil disturbance or accidental fire or explosion or because of action by an enemy or action taken in combating an enemy (whether with or without a declaration of war), then any profits or gains arising from receipt of such money or other asset shall be chargeable to income tax under the head ‘capital gains’ and shall be deemed to be the income of such person of the previous year in which such money or other asset was received.

The money so received or/and fair market value of the other asset received shall constitute the full value of consideration for the purposes of computation of capital gains.

Revaluation of Asset will not amount to ‘transfer’ and hence will not result into any liability under the Income Tax Act. [Well Pack Packaging v. CIT (2003) 130 Taxamnn 215 (Mag.).]

**Withdrawal of exemption in certain cases (Section 47A)**

Section 47A provides that if, at any time, before the expiry of eight years from the date of transfer of a capital asset by a company to its wholly owned subsidiary company as provided in clauses (iv) or (v) of Section 47, or by the subsidiary company to the holding company respectively, such capital asset is converted by the transferee company into or is treated by it as, stock-in-trade of its business, or the parent company (or its nominee) or the holding company ceases to hold the whole of the share capital of the subsidiary company before the expiry of the period of eight years aforesaid, the amount of capital gains exempted from tax by virtue of the provisions contained in Section 47 will be deemed to be income of the transferor company chargeable under the head ‘capital gains’ of the year in which such transfer took place.

In terms of Section 47A(2) where a person gets exemption from capital gains tax on transfer of his membership in a recognised stock exchange during the course of corporatisation of his business in terms of Section 47(xi) and he within three years from the date of such transfer sells any of the shares allotted in lieu thereof by the company, the capital gains exempted vide Section 47(xi) will become the capital gains of the previous year in which the shares are transferred.
In terms of Section 47A(3) inserted by Finance (No. 2) Act, 1998, if the conditions stipulated regarding the succession of proprietary concern or firm by the company whereby capital gain is not levied, are not complied with the benefits availed by the sole proprietor or the firm, as the case may be, shall be deemed to be profit and gains of the successor company chargeable to tax in the year in which infringement takes place.

As per section 47A(4) where any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset or share or shares not charged under section 45 by virtue of conditions laid down in the said proviso shall be deemed to be the profits and gains chargeable to tax of the successor limited liability partnership or the shareholder of the predecessor company, as the case may be, for the previous year in which the requirements of the said proviso are not complied with.

5.42 TRANSFER IN THE PREVIOUS YEAR

Capital gains are to be taxed in the previous year in which the transfer of the capital asset has been effected. In *Cable and Wireless Ltd. v. V.H. Gangal and another* [(1973) 90 ITR 84], the Bombay High Court held that the words ―previous year‖ appearing in Section 45 of the Act indicate that capital gains are chargeable to tax in the year of transfer of capital asset.

5.43 GAIN ON TRANSFER

What is sought to be taxed under Section 45 is the profit or gain arising from transfer of a capital asset. The exact method of computing the capital gain in Section 48 is dealt with later in this study.

5.44 DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION (SECTION 46)

Section 46(1) provides that notwithstanding anything contained in Section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of Section 45. This sub-section applies only to the distribution of capital assets in specie by a company in liquidation among its shareholders. Capital gains made by the liquidator of a company on sale of the company's assets with the object of distributing the sale proceeds among shareholders, are assessable in the hands of the company *[Kannan Rice Mills Ltd. v. C.I.T. (1954) 26 ITR 351]*. Further analysis of this sub-section would reveal that if the distribution is otherwise than on liquidation of the company, this section cannot be attracted. Moreover, the distribution of assets should have been made to the shareholders of the company. -Shareholders‖ would mean registered shareholders only and not the beneficial owners of shares *[Howrah Trading Co. Ltd. v. C.I.T. (1959) 36 ITR 215 (S.C.)]*.

Sub-section (2) of Section 46 provides that where a shareholder, on the liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head -capital gains‖ in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of sub-clause (c)
of clause (22) of Section 2 and the sum so arrived at shall be deemed to be the full value of the consideration for the purpose of Section 48. But for this sub-section, any cash or other assets received by a shareholder on liquidation of the company would not be assessable to tax as capital gains. [C.I.T. v. Chimanlal B. Parikh (1973) 92 ITR 59].

It is once again emphasised that but for the enlarged scope of the definition of the term ‘transfer’ in Section 2(47) and Section 46(2) of the Income-tax Act, 1961, the money received by a shareholder from the company on liquidation would not be brought to tax, as the money received by him represents only satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to the sale, exchange, relinquishment or other transfer of his shares [C.I.T. v. Madurai Mills Company Ltd. (1973) 89 ITR 45 (S.C.)]. Thus, the distributed assets and/or moneys which are, as a matter of fact not a consideration for ‘transfer’ are deemed, under Section 46(2), to be capital gains chargeable to tax.

5.45 SHORT-TERM AND LONG-TERM CAPITAL GAINS

Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. According to Section 2(42A) of the Income-tax Act:

“Short term” capital asset means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer.

In determining the period for which a capital asset is held by an assessee, the following must be noted:

(i) In the case of shares held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation shall be excluded.

(ii) In case the asset becomes the property of the assessee under the circumstances mentioned in Section 49(1) — discussed later in this study - the period for which the asset was held by the previous owner shall be included.

(iii) In the case of the shares in an Indian Company which become the property of the assessee in a scheme of amalgamation, the period for which the shares in the amalgamating company were held by the assessee shall be included.

(iv) In the case of a capital asset, being a share or any other security subscribed to by the assessee on the basis of his right to subscribe to such financial asset or subscribed to by the person in whose favour the assessee has renounced his right to subscribe to such financial asset, the period shall be reckoned from the date of allotment of such financial asset;

(v) In the case of a capital assets, being the right to subscribe to any financial asset, which is renounced in favour of any other person, the period shall be reckoned from the date of the offer of such right by the company or institution, as the case may be, making such offer.

(vi) In the case of a capital asset, being a financial asset, allotted without any
payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset.

(vii) In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.

(viii) In the case of a capital asset, being trading or clearing rights of a recognized stock exchange in India acquired by a person pursuant to demutualisation or corporatisation of the recognized stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation;

(viiia) In the case of a capital asset, being equity share or shares in a company allotted pursuant to demutualisation or corporatisation of a recognised stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation;

Assets other than short-term capital assets are known as ‘long-term capital assets’ and the gains arising therefrom are known as ‘long-term capital gains’. Note that with effect from assessment year 1988-89, a share, equity or preference held by an assessee would be regarded as a long-term capital asset if the ownership is for more than 12 months with him. In the case of other long-term capital assets, the period of holding is determinable subject to any rules made by CBDT.

<table>
<thead>
<tr>
<th>Test Your Knowledge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term capital asset means a capital asset held by an assessee for not more than _____ immediately preceding the date of its transfer.</td>
</tr>
<tr>
<td>(a) 15 months</td>
</tr>
<tr>
<td>(b) 20 months</td>
</tr>
<tr>
<td>(c) 36 months</td>
</tr>
<tr>
<td>(d) 12 months</td>
</tr>
</tbody>
</table>

Correct Answer: (c)

5.46 ZERO COUPON BONDS

Computation of capital gain in certain cases

The Finance Act, 2005 has introduced the procedure regarding the taxation of the income on the Zero Coupon Bonds being issued on or after 1.6.2005. “Zero Coupon Bond” as defined under Section 2(48) means a bond—

(a) issued by any infrastructure capital company or infrastructure capital fund or public sector company on or after the 1st day of June, 2005;
(b) in respect of which no payment or benefit is received or receivable before maturity or redemption from infrastructure capital company or infrastructure capital fund or public sector company; and

(c) which the Central Government may, by notification in the Official Gazette, specify in this behalf.

For the purpose of this clause, the expressions “infrastructure capital company” and “infrastructure capital fund” shall have the same meanings respectively assigned to them under clauses (a) and (b) of Explanation 1 to clause (23G) of Section 10.

As per Clause (b) above, the payment of and benefit from zero coupon bond shall be received or receivable from the issuing company/fund only at the time of maturity or redemption. Consequently, Clause (via) has been inserted in Section 2(47) to provide that the maturity or redemption of a zero coupon bond shall be regarded as a transfer.

The profits arising on the transfer of such zero coupon bond shall be chargeable under the head “capital gains”. Further, Section 2(42A) has been amended to provide that if such zero coupon bonds are held for not more than 12 months, such capital asset shall be treated as short-term capital asset and hence shall be subject to short-term capital gain. On the other hand, where these bonds are held for more than 12 months, such capital gain shall be treated as long-term capital gain.

The proviso under Section 112(1) has been amended to include zero coupon bonds. Therefore, where the tax payable in respect of any income arising from the transfer of a long-term capital asset being zero coupon bonds exceeds 10% of the amount of capital gain, before giving effect to the provisions of the second proviso to Section 48 (i.e. before giving effect to indexed cost) such excess shall be ignored for the purpose of computing the tax payable by the assessee.

In other words, long term capital gain on zero coupon bonds shall be chargeable to tax at minimum of the following two:

(a) 20% of long term capital gain after indexation of cost of such bonds, or
(b) 10% of long term capital gain before indexation of cost of such bonds.

5.47 MODE OF COMPUTATION AND DEDUCTIONS

Section 48 of the Act provides that the income chargeable under the head ‘capital gains’ shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely (as applicable from the assessment year 1993-94) -

(i) the expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the capital asset and the cost of any improvement thereto.

However, in the case of an assessee who is a non-resident, capital gains arising
from the transfer of a capital asset, being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency.

Further, the above manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in, and sale of, shares in, or debentures of, an Indian Company.

Where long term capital gain arises from the transfer of a long term capital asset (other than capital gain arising to a non-resident from the transfer of shares in or debentures of an Indian company), such long term capital gains will be computed by deducting from the full value of consideration, the expenditure incurred in connection with the transfer, the indexed cost of acquisition and indexed cost of improvement.

The Finance Act, 1997 has with effect from 1.4.1998 denied the benefit of indexation of cost of bonds and debentures other than indexed bonds issued by the government.

Provided also that where shares, debentures or warrants referred to in the proviso to Clause (iii) of Section 47 are transferred under a gift or an irrevocable trust, the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for the purposes of this section.

For this purpose:

(i) “foreign currency” and “Indian currency” have the meanings respectively assigned thereto in Section 2 of the Foreign Exchange Management Act, 1999, and

(ii) the conversion of Indian currency into foreign currency and the re-conversion of foreign currency into Indian currency shall be at the rate of exchange prescribed in that behalf;

(iii) ‘indexed cost of acquisition’ means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April 1981 whichever is later;

(iv) ‘indexed cost of any improvement’ means an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place; and

(v) ‘cost inflation index’, in relation to a previous year, means such Index as the Central Government may, having regard to seventy-five per cent of average rise in the Consumer Price Index for urban non-manual employees for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify in this behalf.
Commission paid to a broker for effecting sale of the asset falls under (i) above. Similarly expenditure incurred on litigation for getting enhanced compensation is expenditure wholly and exclusively incurred in connection with transfer of the capital asset and is deductible. [V.A. Vasumathi v. C.I.T. (1980)123 ITR 94 (Ker.)]. However, litigation expenses incurred for having the shares registered in his name are part of the cost of acquisition and that incurred for gaining better voting rights is cost of improvement [C.I.T. v. Bengal Assam Investors Ltd. (1969) 72 ITR 319 (Cal.)] (Cost of improvement and cost of acquisition are elaborately explained under para 9).

Section 48 of the Act does not an Assessing Officer from taking into amount sale consideration stated in the deed or actual consideration received by the assessee whichever is higher. [Interpal Singh Ahuja v. CIT (2006) 103 ITD/100 TTJ 497 (Asr.)].

Formula for computation of -
Indexed Cost of Acquisition and
Indexed Cost of Improvement.

Indexed Cost of Acquisition

Cost of acquisition shall have to be adjusted by the Cost Inflation Index to arrive at the indexed cost of acquisition, as follows:

For assets acquired before 1.4.1981 by the assessee

\[
\text{Indexed Cost of Acquisition} = \frac{\text{Cost of Acquisition} \times \text{Cost Inflation Index for the financial year in which the asset is transferred}}{\text{Fair Market Value of the asset as on 1.4.1981, whichever is higher}}
\]

(Cost Inflation Index for 1981-82)

Indexed Cost of Acquisition = \frac{\text{Cost of improvement} \times \text{Cost Inflation Index}}{\text{Cost Inflation Index for 1981-82}}

Also add cost of improvement before 1.4.81.

For assets acquired by the assessee on or after 1.4.1981

Indexed Cost of Acquisition = \text{Cost of Acquisition} \times \text{Cost Inflation index for the year in which the asset is transferred}

Cost Inflation Index for the first year in which the asset is acquired by the assessee

Indexed Cost of Improvement

\[
\text{Indexed Cost of Improvement} = \frac{\text{Cost of improvement} \times \text{Cost Inflation Index for the year in which improvement to the asset took place}}{\text{Cost Inflation Index for the year in which the asset is transferred}}
\]
Cost Inflation Index specified for purpose of computation of capital gains

In exercise of the powers conferred by clause (v) of the Explanation to Section 48 of the Income-tax Act, 1961 (43 of 1961), the Central Government; having regard to seventy-five per cent of the average rise in the Consumer Price Index for urban non-manual employees, has specified the Cost Inflation Index as mentioned in column (3) of the Table below for the financial year mentioned in the corresponding entry in column (2) of the said Table.

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Financial year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>1981-82</td>
<td>100</td>
</tr>
<tr>
<td>2.</td>
<td>1982-83</td>
<td>109</td>
</tr>
<tr>
<td>3.</td>
<td>1983-84</td>
<td>116</td>
</tr>
<tr>
<td>4.</td>
<td>1984-85</td>
<td>125</td>
</tr>
<tr>
<td>5.</td>
<td>1985-86</td>
<td>133</td>
</tr>
<tr>
<td>6.</td>
<td>1986-87</td>
<td>140</td>
</tr>
<tr>
<td>7.</td>
<td>1987-88</td>
<td>150</td>
</tr>
<tr>
<td>8.</td>
<td>1988-89</td>
<td>161</td>
</tr>
<tr>
<td>9.</td>
<td>1989-90</td>
<td>172</td>
</tr>
<tr>
<td>10.</td>
<td>1990-91</td>
<td>182</td>
</tr>
<tr>
<td>11.</td>
<td>1991-92</td>
<td>199</td>
</tr>
<tr>
<td>12.</td>
<td>1992-93</td>
<td>223</td>
</tr>
<tr>
<td>13.</td>
<td>1993-94</td>
<td>244</td>
</tr>
<tr>
<td>14.</td>
<td>1994-95</td>
<td>259</td>
</tr>
<tr>
<td>15.</td>
<td>1995-96</td>
<td>281</td>
</tr>
<tr>
<td>16.</td>
<td>1996-97</td>
<td>305</td>
</tr>
<tr>
<td>17.</td>
<td>1997-98</td>
<td>331</td>
</tr>
<tr>
<td>18.</td>
<td>1998-99</td>
<td>351</td>
</tr>
<tr>
<td>19.</td>
<td>1999-00</td>
<td>389</td>
</tr>
<tr>
<td>20.</td>
<td>2000-01</td>
<td>406</td>
</tr>
<tr>
<td>21.</td>
<td>2001-02</td>
<td>426</td>
</tr>
<tr>
<td>22.</td>
<td>2002-03</td>
<td>447</td>
</tr>
<tr>
<td>23.</td>
<td>2003-04</td>
<td>463</td>
</tr>
<tr>
<td>24.</td>
<td>2004-05</td>
<td>480</td>
</tr>
<tr>
<td>25.</td>
<td>2005-06</td>
<td>497</td>
</tr>
<tr>
<td>26.</td>
<td>2006-07</td>
<td>519</td>
</tr>
<tr>
<td>27.</td>
<td>2007-08</td>
<td>551</td>
</tr>
<tr>
<td>28.</td>
<td>2008-09</td>
<td>582</td>
</tr>
<tr>
<td>29.</td>
<td>2009-10</td>
<td>632</td>
</tr>
<tr>
<td>30.</td>
<td>2010-11</td>
<td>711</td>
</tr>
<tr>
<td>31.</td>
<td>2011-12</td>
<td>785</td>
</tr>
</tbody>
</table>
Illustration:

On 15th November, 2011 Mohan sold 1 kg. of gold, the sale consideration of which was ₹ 4,50,000. He acquired the gold on August 18, 1978 for ₹ 64,000. Fair market value of 1 kg. of gold on April 1, 1981 was ₹ 62,000.

Find out the amount of capital gain chargeable to tax for the assessment year 2012-13 using the cost inflation index table as given.

**Computation of capital gains:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds of gold</td>
<td>₹ 4,50,000</td>
</tr>
<tr>
<td>Less: Indexed Cost of Acquisition</td>
<td>₹ 4,86,700</td>
</tr>
<tr>
<td>Long-term Capital loss</td>
<td>₹ 36,700</td>
</tr>
</tbody>
</table>

**Determination of Indexed Cost of Acquisition**

In this case since the asset was purchased before 1.4.1981 and fair market value of gold as on 1.4.1981 is more than the cost of acquisition of gold, it is beneficial for the assessee to opt for Fair Market Value of gold as on 1.4.1981 for computation of capital gains.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Market Value of Gold on 1.4.1981</td>
<td>₹ 62,000</td>
</tr>
<tr>
<td>Cost inflation index - for the year 1981-82</td>
<td>100</td>
</tr>
</tbody>
</table>

Indexed cost of acquisition \( \left( \frac{62,000 \times 785}{100} \right) = 4,86,700 \)

**Tax on Long-term Capital Gains (Section 112)**

Section 112 has been inserted with effect from April 1, 1993 for computation of Income-tax on Long-term Capital gains. Long-term Capital gains will be taxable at a flat rate 20%.

Finance Act, 1999 with effect from assessment year 2000-01 has provided that -

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>In respect of listed securities or units or zero tax coupon bonds, assessees have the option of:</td>
<td></td>
</tr>
<tr>
<td>— paying tax @ 20% on long-term capital gain computed by considering the 'indexed' cost of acquisition and improvement; or</td>
<td></td>
</tr>
<tr>
<td>— paying tax @ 10% on long-term capital gains computed by considering the actual i.e. the historical cost.</td>
<td></td>
</tr>
</tbody>
</table>

This option can be exercised separately in respect of each transaction i.e. exercise of the first option in respect of one transaction does not preclude the
assessee from exercising the second option in respect of a subsequent transaction(s) during the same previous year.

Assessees must exercise this choice judiciously on a comparison of tax liability under the two options. In respect of long-term capital gains from transfer of bonus shares, invariably the second option will be exercised.

The assets covered under this provision are securities defined under Section 2(h) of the Securities Contracts (Regulation) Act, 1956 listed on any recognised stock exchange in India.

As per Section 2(h) -Securities includes shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature of any company, Government Securities and other notified instruments.

In respect of such long-term capital gain, deductions under Chapter VIA (i.e. under Sections 80C to 80U) are not allowed. Further, income other than long term capital gains will be subject to tax at the rates in force.

**5.48 COSTS WITH REFERENCE TO CERTAIN MODES OF ACQUISITION**

Capital gains are ascertained after taking into consideration the cost of acquisition of the capital asset by the assessee. The cost of acquisition is easily determinable where the asset has been purchased by the assessee. In some cases the assessee would have acquired the asset not necessarily by purchase but by the following modes namely:

**(A) Cost to the previous owner:**

(i) on the distribution of assets on the total or partial partition of a Hindu Undivided Family;

(ii) under a gift or will;

(iii) (a) by succession, inheritance or devolution; or

(b) on any distribution of assets on the dissolution of a firm, body of individuals or other association of persons where such dissolution has taken place at any time before 1.4.1987; or

(c) on any distribution of assets on the liquidation of a company; or

(d) under a transfer to a revocable or irrevocable trust; or

(e) under any such transfer as is referred to in clause (iv) or clause (v) or clause (vi) or clause (via) of Section 47 - see para 3 already discussed.

(iv) by the mode referred to in Sub-section (2) of Section 64 at any time after 31.12.1969, by an assessee, being a Hindu Undivided Family.

In all the above cases, Section 49(1) states that the cost of acquisition of the assets shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets, incurred or borne by the previous owner or the assessee as the case may be. *Previous owner of the property* means the last previous owner of the capital asset who acquired it by a mode other than that referred to in (i) to (iv) above. An example would make this point clear. X had built a house at a cost of ₹ 50,000. X gifted the house to Y, Y to Z and Z
to A. The cost of acquisition of the house for A for the purpose of ascertaining any capital gain arising on the sale of the house by A would be ₹ 50,000. In other words, since the previous owner, namely, Z, acquired it free of cost, i.e., by gift, it cannot be said that cost of acquisition of the house for A is nil.

Section 55(3) of the Act provides that where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

(B) **Cost of shares in the amalgamated company**:

Sub-section (2) of Section 49 provides that where the capital asset being a share or shares in an amalgamated company which is an Indian company became the property of the assessee in consideration of a transfer referred to in clause (vii) of Section 47, the cost of acquisition of the asset shall be deemed to be the cost of acquisition to him of the share or shares in the amalgamating company.

(C) **Cost of acquisition in cases of conversion of debenture/debenture stock/deposit certificate into shares**:

Sub-section 2A, as inserted retrospectively from 1.4.1962 by Finance (No. 2) Act, 1991 states that where the capital asset being a share or debenture in a company became the property of the assessee in consideration of a transfer referred to in Section 47(x), the cost of acquisition of the asset to the assessee shall be deemed to be that part of the cost of debenture, debenture stock or deposit certificates in relation to which such asset is acquired by the assessee.

(D) Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in sub-clause (vi) of clause (2) of section 17, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for the purposes of the said sub-clause. [Section 49(2AA)]

(E) Further, Sub-section (3) of Section 49 provides that where the capital gain arising from the transfer of a capital asset referred to in Section 47(iv) or (v) is deemed, by virtue of the provisions in Section 47A, to be income chargeable under the head ‘capital gains’, the cost of acquisition of such asset to the transferee company will be the cost for which such asset was acquired by it.

5.49 **MEANING OF COST OF ACQUISITION [SECTION 55(2)]**

For the purposes of Sections 48 and 49, ‘cost of acquisition’ of goodwill of a business or a right to manufacture, produce or process any article or thing, tenancy rights, stage carriage permits or loom hours is:

(i) in the case of acquisition of such asset by the assessee by purchase from a previous owner, cost of acquisition means the amount of the purchase price; and

(ii) in any other case cost of acquisition shall be Nil.

**Cost of an asset acquired before 1.4.1981**:

(i) where the capital asset became the property of the assessee before
1.4.1981, cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset as on 1.4.1981 at the option of the assessee and the indexation of cost will be available with reference to such actual cost of acquisition or the FMV as opted for by the assessee;

(ii) where the capital asset became the property of the assessee by any of the modes specified in Section 49(1) and the capital asset became the property of the previous owner before 1.4.1981 cost of acquisition means the cost of capital asset to the previous owner or the fair market value of the asset as on 1.4.1981 at the option of the assessee. However the indexation will commence from the year in which the asset became the property of the assessee and not 1981-82.

If a depreciable capital asset becomes the property of assessee under the circumstances mentioned in para 9, he has got an option to substitute the fair market value of the asset on April 1, 1981 in place of its cost of acquisition. If, however, an assessee acquires a depreciable asset in the circumstances, other than those mentioned in para 9, he cannot opt for fair market value on April 1, 1981 in the place of its cost of acquisition [Section 50(2) - Rajnagar Vaktapur Ginning, Pressing & Mfg. Co. Ltd. v. CIT (1975) 99 ITR 264 (Guj.) and India Jute Co. Ltd. v. CIT (1981) 6 Taxman 239 (Cal.)].

Unearned increase in value of land is not to be deducted while determining FMV (Fair Market Value) of property as on April 1, 1981. [CIT v. Rekha Mathur (2006) 152 Taxman 70 (Mag.) (Del.)].

The option given to the assessee to substitute the fair market value of the asset on 1.4.1981 is to ensure that capital gains are not computed with reference to some historical cost; and thus mitigate the hardship to some of the assessee who would have acquired the asset at cheaper cost, fifteen or even twenty years back. Keeping in view this, the Finance Act, 1992 has introduced the system of indexation which has already been discussed elsewhere in this chapter.

Cost of assets acquired on liquidation of a company

(iii) where the capital asset became the property of the assessee on the distribution of capital assets of a company on its liquidation and the assessee has been assessed to income-tax under the head ‘capital gains’ in respect of that asset under Section 46, ‘cost of acquisition’ means the market value of the asset on the date of distribution.

Cost of Securities

Cost of original shares, acquired directly from a company or otherwise, shall be deemed to be the actual price paid therefor just as the cost of rights shares shall be deemed to be the actual price paid therefor to the company plus any amount to the renouncer. Cost of bonus shares shall be deemed to be Nil. Cost of renunciation of rights shall also be deemed to be Nil.

Cost on consolidation or conversion of shares

(iv) where the capital asset, being a share or a stock of a company, became the property of the assessee on -

(a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares;
(b) the conversion of any shares of company into stock;
(c) the reconversion of any stock of company into shares;
(d) the sub-division of any of the shares of the company into shares of smaller amount; or
(e) the conversion of one kind of shares of the company into another kind,

the „cost of acquisition” means the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

In relation to a capital asset, being equity share or shares allotted to a shareholder of a recognised stock exchange in India under a scheme for corporatisation approved by the Securities and Exchange Board of India Act, 1992 (15 of 1992), shall be the cost of acquisition of his original membership of the exchange.

Example 3: X bought 100 shares of र 10 each fully paid @ र 15 per share. The company sub-divided shares into shares of र 5 each (fully paid). X later on sold 50 of the shares @ र 8 each.

| Sale proceeds or consideration received | 50 x र 8 | 400 |
| Less: Cost of acquisition: 50 shares now sold by X have been derived from 25 shares which he had originally acquired @ र 15 per share. Cost of acquisition of these 50 shares will be 25 x र 15 | 375 |


This circular of the department on the “cost of acquisition” is also worth noting:

Where an assessee acquires an asset by inheritance from a person who in turn had also acquired the same by inheritance before 1.1.1954 (now 1.4.1981) the assessee has the option of substituting the fair market value of the asset as at 1.1.1954 (now 1.4.1981) in place of the original cost, if it is to his advantage. On the basis of this a view could be taken as follows:
(i) the fair market value of original shares on 1.4.1981 can be adopted if such shares have been substituted or consolidated after that date, and
(ii) the indexation should be made with reference to either the year of acquisition of original shares or 1.4.1981, whichever is later.

5.50 ADVANCE MONEY RECEIVED

Section 51 of the Act provides that where any capital asset was on any previous occasion the subject of negotiation for its transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be in computing the cost of acquisition.
5.51 COST OF IMPROVEMENT

Section 55(1)(b) provides that where the capital asset became the property of the previous owner or the assessee before 1.4.1981, the cost of any improvement means all expenditure of a capital nature incurred in making any additions or alterations to the capital asset on or after the said date by the previous owner or the assessee. In other cases, it means all capital expenditure in making any additions or alterations by the assessee after it became his property and where the capital asset became the property of the assessee by any of the modes specified in Section 49(1) by the previous owner as the case may be. If, however, any part of the expenditure is deductible in computing the income chargeable under the head “Interest on securities”, “Income from house property”, “Profits and gains of business or profession” or “Income from other sources”, such expenditure cannot be included as cost of improvement. For example, a house is bought out of borrowed money. The interest paid on the loan till the date of completion of construction has been held to be part of cost of acquisition of the house. But ground rent paid which is deductible while computing income under the head “Income from house property” cannot be taken to be cost of improvement and hence cannot be added to the cost of acquisition.

However, the ‘Cost of any improvement’ at sub-clause (b) of Clause 1 of Section 55, in relation to a capital asset being goodwill of a business, shall be taken to be nil.

5.52 CAPITAL GAINS IN CASE OF DAMAGE OR DESTRUCTION OF CAPITAL ASSET (W.E.F. ASSESSMENT YEAR 2000-01) [SECTION 45(1A)]

Where any person receives at any time during the previous year any money or other asset under an insurance from an insurer on account of damage to or destruction of, any capital asset, as a result of:

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

then, any profits or gains arising from receipt of such money or other asset shall be chargeable to tax under the head ‘Capital Gains’. The income shall be deemed to be the income for the previous year in which such money or other asset is received. For computing capital gains, the value of any money or the fair market value of asset received on the date of receipt shall be deemed to be the full value of consideration received or accruing as a result of the transfer of damaged asset.

5.53 TRANSFER OF SECURITIES HELD WITH DEPOSITORY [SECTION 45(2A)]

Where any person has had at any time during the previous year any beneficial interest in securities, then, any profits or gains arising from transfer made by the Depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which transfer took place and not of the Depository who is deemed to be the registered owner of Securities.
The cost of acquisition and the period of holding of any securities shall be determined on first-in-first-out basis. [vide Circular No. 768, dated 24-6-98, issued by CBDT]

**5.54 COMPUTATION OF CAPITAL GAINS ON PURCHASE BY COMPANY OF ITS OWN SHARES OR OTHER SPECIFIED SECURITIES (W.E.F. ASSESSMENT YEAR 2000-01)**

Where a company purchases its own shares from a shareholder or other specified securities from its holder, then the capital gains shall be chargeable to tax in the hands of transferor. The capital gains shall be computed as provided in Section 48 in the year in which such shares or specified securities are purchased by the company.

**5.55 CAPITAL GAINS EXEMPT FROM TAX**

Under Sections 54, 54B, 54D, 54EC, 54F, 54G and 54H of the Act, capital gains arising from the transfer of certain capital assets are exempt from tax under certain circumstances. These provisions are dealt with section wise below.

**5.55.1 PROFIT ON SALE OF PROPERTY USED FOR RESIDENCE (SECTION 54)**

Where any capital gain arises to an assessee, individual or H.U.F., on the transfer of a long-term residential house (either self-occupied or let out), the income of which is chargeable under the head, ‘Income from house property’, and where the assessee (or in case of his death, his legal representative) has (i) purchased a residential house within a period of one year before such transfer or within a period of two years after such transfer, or (ii) constructed a residential house within three years after such transfer, the capital gain arising on such transfer is to be treated in the following manner:

(i) The capital gain arising on the transfer of such residential house is exempt to the extent it is re-invested in the purchase or construction of another residential house within the period as aforesaid. If the entire capital gain is re-invested, it is fully exempt from income-tax and not includible in the total income of the assessee. If only a part thereof is re-invested, the balance is chargeable to income-tax. The allotment of flats under self-financing scheme of Delhi Development Authority is treated as a new construction for the purposes of capital gain exemption (under Section 54).

(ii) The new residential house so purchased or constructed should not be transferred within a period of three years of its purchase or construction as the case may be. If it is transferred within such period of three years, the cost of the new house so purchased or constructed is to be reduced by the amount of old exempted capital gain. In other words, the old exempted capital gain and new capital gain, if any arising on the transfer of the new residential house, both are chargeable to tax as the income of the previous year in which the new residential house is transferred. If the transfer of the new house is effected after the expiry of three years of its purchase or construction, the cost of the new house so purchased or constructed is not to be reduced by the amount of old exempted capital gain. In other words, the old exempted gain is not taxable in such cases.
(iii) Where the amount of capital gain which is not appropriated or utilised by the assessee for the purchase of a residential house within one year before the date of the transfer or which is not utilised by him for the purchase or construction of a new residential house before the date for furnishing the return of income (under Section 139), the unutilised amount has to be deposited on or before the due date for furnishing the return of income in an account in any bank or institution specified by the Central Government. The return of income should be furnished along with proof of such deposit. The amount already utilised for the purchase or construction of the new residential house together with the amount so deposited shall be deemed to be the amount utilised for the purchase or construction of the new residential house. Thus, the assessee is allowed exemption in respect of capital gain so utilised or deposited.

The assessee has to utilise the amount so deposited for the purchase or construction of the new residential house within the specified period as aforesaid [under Section 54(1)]. When the deposited amount is not so utilised either wholly or partly for the purchase or construction of the new residential house, the unutilised amount is treated as capital gain of the relevant previous year in which the period of three years from the date of such transfer expires.

Case Laws:

In connection with above section the following decisions of the courts are worth noting:

(a) [\textit{Smt. Shantaben P. Gandhi v. CIT} (1981) 129 ITR 218 (Guj.)]; Where the assessee constructs the house before transfer, he is not entitled to exemption under Section 54

(b) [\textit{CIT v. T.N. Arvinda Reddy} 120 ITR 46 (SC)]; Where the members of a Hindu undivided family execute a release deed in the common house in favour of a member of the family for a consideration it amounts to purchase under Section 54(1)

(c) [\textit{B.B. Sarkar v. CIT} (1981) 132 ITR 150]. Where the amount of capital gains is spent both on purchase of house property and on further construction on it, exemption is available in respect of both the amounts

(d) [\textit{K.C. Kaushik v. P.B. Rane, ITO} (1990) 84 CTR (Bom.) 62]. Where more than one house/flat has been purchased within the prescribed period under Section 54, it is for the assessee to claim relief against the purchase of any one of the house/flat provided the other conditions mentioned in the section are satisfied.

(e) [\textit{CIT v. J.R. Subramanya Bat} (1987) 165 ITR 571 (Kar.) \textit{CIT v. H.K. Kapoor} (1998) 150 CTR (All) 128]. The date of commencement of the construction of the new house is not material. To get the benefit of Section 54, the assessee must have constructed the new house within the prescribed period from the date of sale of the old house.

(f) [\textit{CIT v. Mrs. Shahzada Begum} (1988) 173 (ITR) 397 (AP)]. Date of taking over possession of property purchased, and not the date of registration of
sale in favour of the assessee, is relevant for computing the prescribed time limit.

(g) [CIT v. Dr. Laxmichand Narpal Nagda (1995) 211 ITR 804 (Bom.)]. The word ‘purchase’ is not used in the sense of legal transfer and therefore the holding of a legal title within a period of one year is not a condition precedent for attracting Section 54.

(h) [Saleem Fazelbhoy v. CIT (2006) 9 SOT 601 (Mum.)]. For the purpose of claiming deduction under Section 54, not only the purchase price is taken into consideration but also incident as cost required to make the home habitable is also to considered.

(i) [D. Anand Bassappa v. ITO (2004) 9 ITD 53 (Bang.)]. To claim deduction under Section 54, there is no bar on acquiring more than one residential house out of the proceeds of one residential house.

5.55.2 TRANSFER OF LAND USED FOR AGRICULTURAL PURPOSES
(SECTION 54B)

Where any capital gain either long-term or short-term arises on the transfer of land which, in the two years immediately preceding the date of transfer, was being used by the assessee or his parents for agricultural purposes and where the assessee has purchased any other agricultural land within a period of two years after the date of its transfer, such capital gain is to be treated as under:

(i) The capital gain arising on the transfer of old agricultural land is exempt to the extent it is reinvested in the purchase of any other agricultural land within the aforesaid period. If whole capital gain is reinvested, it is fully exempt from income-tax and not includible in the total income of the assessee. If only a part of it has been re-invested, the balance of it is chargeable to income-tax. New land may be in rural or urban area.

(ii) New agricultural land so purchased should not be transferred within three years of its purchase. If it is sold before the expiry of three years, the cost of the new agricultural land is to be reduced by the amount of old exempted capital gain [Section 54B(1)].

(iii) The amount of capital gain not utilised by the assessee for purchase of new agricultural land before the date for furnishing the return of his income is to be deposited by him, on or before the due date for furnishing the return of income, in an account in any bank or institution specified by the Central Government. The amount already utilised for the purchase of agricultural land together with the amount so deposited is deemed to be the amount utilised for the purchase of agricultural land. Accordingly, the assessee is allowed exemption in respect of capital gain so utilised or deposited [Section 54B(2)].

The assessee is also required to utilise the amount of deposit for the purchase of agricultural land within the specified period as aforesaid [Section 54B(1)]. If the deposited amount is not so utilised for the purchase of agricultural land, the unutilised amount is treated as capital gain of the relevant previous year in which the period of two years from the date of such transfer expires.
5.55.3 COMPULSORY ACQUISITION OF LANDS AND BUILDINGS (SECTION 54D)

An assessee is entitled to exemption from tax in respect of capital gains arising from the transfer, by way of compulsory acquisition, of any land or building forming part of an industrial undertaking belonging to him provided the following conditions are satisfied:

(a) The land and buildings form part of an industrial undertaking of the assessee.
(b) It has been so used for at least two years preceding the date of compulsory acquisition.
(c) The assessee purchases any other land and building within a period of three years from the date of acquisition or constructed a building within such period.
(d) The newly acquired lands and buildings are used for the shifting or re-establishment of old industrial undertaking or for setting up new industrial unit.
(e) The new asset is not transferred by the assessee for a period of three years from the date of acquisition.
(f) The capital gains are not chargeable to tax to the extent they are utilised in purchasing the land and building.

Consequences if new land or building is transferred within 3 years:

If new land or building is transferred within a period of three years from the date of its purchase or construction, the amount of capital gains arising therefrom, together with the amount of capital gains exempted earlier, will be chargeable to tax in the year of sale of new land and building.

Scheme of deposit

Where the amount of capital gain is not appropriated or utilised by the assessee for purchase of new asset before the date of furnishing the return of his income, it shall be deposited by him on or before the due date of furnishing the return of income, in an account with a bank or institutions specified in, and utilised in accordance with any scheme framed by the Central Government in this regard. The amount already utilised for purchase or construction of the new asset, together with the amount so deposited, shall be deemed to be the amount utilised for the purchase of a new asset. If the amount deposited is not utilised fully for purchase or construction of a new asset within the stipulated period, then the amount not so utilised shall be treated as the capital gain of the previous year in which the period of three years from the date of transfer of original asset expires. In such case the assessee shall be entitled to withdraw such amount in accordance with the aforesaid scheme.

The words „industrial undertaking“ should be understood to have been used in Section 54D in a wide sense, taking in its fold any project or business a person may undertake. Thus, the running of a lodge’ can also be said to be an ‘industrial undertaking’ within the meaning of Section 54D. [P. Alikunju M.A. Nazeer Cashew Industries v. CIT (1987) 166 ITR 804 (Ker)].
5.55.4 NO TAX ON LONG-TERM CAPITAL GAINS IF INVESTMENTS MADE IN SPECIFIED BONDS (SECTION 54EC)

(1) Where the capital gain arises from the transfer of a long-term capital asset (the capital asset so transferred being hereafter in this section referred to as the original asset) and the assessee has, at any time within a period of six months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset, the capital gain shall be dealt with in accordance with the following provisions of this section, that is to say:

(a) if the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, the whole of such capital gain shall not be charged under Section 45;

(b) if the cost of the long-term specified asset is less than the capital gain arising from the transfer of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acquisition of the long-term specified asset bears to the whole of the capital gain, shall not be charged under Section 45.

(2) Where the long-term specified asset is transferred or converted (otherwise than by transfer) into money at any time within a period of three years from the date of its acquisition, the amount of capital gains arising from the transfer of the original asset not charged under Section 45 on the basis of the cost of such long-term specified asset as provided in Clause (a) or, as the case may be, Clause (b) of Sub-section (1) shall be deemed to be the income chargeable under the head “Capital gains” relating to long-term capital asset of the previous year in which the long-term specified asset is transferred or converted (otherwise than by transfer) into money.

Explanation: In a case where the original asset is transferred and the assessee invests the whole or any part of the capital gain received or accruing as a result of transfer of the original asset in any long-term specified asset and such assessee takes any loan or advance on the security of such specified asset, he shall be deemed to have converted (otherwise than by transfer) such specified asset into money on the date on which such loan or advance is taken.

(3) Where the cost of the long-term specified asset has been taken into account for the purposes of Clause (a) or Clause (b) of Sub-section (1)—

(a) a deduction from the amount of income-tax with reference to such cost shall not be allowed under Section 88 for any assessment year ending before the 1st day of April, 2006;

(b) a deduction from the income with reference to such cost shall not be allowed under Section 80C for any assessment year beginning on or after the 1st day of April, 2006.

(a) “cost”, in relation to any long-term specified asset, means the amount invested in such specified asset out of capital gains received or accruing as a result of the transfer of the original asset;

(b) “long-term specified asset” means any bond redeemable after three years issued on or after 1st day of April, 2006.
Benefit of the exemption will be available only if the gains are invested in bonds of NHAI and RECL that are issued on or after 1-4-2006. (w.e.f. A.Y. 2006-07)

Section 54EC is attracted where long term capital asset is transferred. So an assessee can avail benefit of Section 54EC with respect to depreciable asset. [CIT v. ACE Builders (P) Ltd. (2005) 144 Taxman 855 (Bom.).]

5.55.5 CAPITAL GAINS ON TRANSFER OF CERTAIN LISTED SECURITIES OR UNIT, NOT TO BE CHARGED IN CERTAIN CASES (SECTION 54ED).

The benefit of exemption under this section is being withdrawn w.e.f. A.Y. 2007-08 in respect of asset transferred on or after 1-4-2006 as long-term capital gain from such shares/units is fully exempt under Section 10(38) and short-term capital gain from such shares/units is taxable at a special rate of 10%.

5.55.6 CAPITAL GAIN ON THE TRANSFER OF CERTAIN CAPITAL ASSETS NOT TO BE CHARGED IN CASE OF INVESTMENT IN RESIDENTIAL HOUSE (SECTION 54F)

Where in the case of an assessee being an individual or a Hindu Undivided Family, the capital gain arises from the transfer of any long-term capital asset, not being a residential house (hereafter in this section referred to as the original asset), and the assessee has, within a period of one year before or two years after the date on which the transfer took place purchased, or has within a period of three years after that date constructed, a residential house (hereafter in this section referred to as the new asset), the capital gain shall be dealt with in accordance with the following provisions of this section, that is to say:

(a) if the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of such capital gain shall not be charged under Section 45;

(b) if the cost of the new asset is less than the net consideration in respect of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of the new asset bears to the net consideration, shall not be charged under Section 45.

Provided that nothing contained in this section shall apply where:

(a) the assessee:
   (i) owns more than one residential house, other than the new asset, on the date of transfer of the original asset; or
   (ii) purchases any residential house, other than the new asset, within a period of one year after the date of transfer of the original asset; or
   (iii) constructs any residential house, other than the new asset, within a period of three years after the date of transfer of the original asset; and

(b) the income from such residential house, other than the one residential house owned on the date of transfer of the original asset, is chargeable under the head “Income from house property”.

For the purposes of this section “Net consideration” means full value of the
consideration received or accruing as a result of transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

**Forfeiture of the Exemption:**

If the assessee sells the newly purchased or constructed house within a period of 3 years of its purchase or construction, as the case may be, the old exempted long-term capital gain would be chargeable to tax as long-term capital gain in the previous year in which the house so purchased or constructed is transferred. If the transfer of the new residential house is effected after the expiry of three years of its purchase or construction, the old exempted long term capital gain is not chargeable to tax [Section 54F(3)].

Sub-section (4) of Section 54F further provides that the net consideration which is not appropriated by the assessee for the purchase of a residential house within one year before the date of such transfer, or which is not utilised by him for the purchase or construction of a residential house before the date of furnishing the return of income (under Section 139), has to be deposited by him before the due date of furnishing the return of income [under Section 139(1)] in an account in any bank or institution specified by the Central Government. The amount already utilised by him for the said purpose together with the amount so deposited is deemed to be the cost of the new asset. Accordingly, the assessee is entitled to exemption in respect of the capital gain on such basis. The return of income filed by the assessee has to be accompanied by proof of such deposit.

The assessee is required to utilise the amount of deposit for the purchase or construction of a residential house within the aforesaid specified period [under Section 54F(1)]. If the deposited amount is not so utilised, wholly or partly, for the purchase/construction of new house within the specified period, the excess amount of exemption shall be treated as capital gains of the previous year in which the period of three years from the date of the transfer of the original asset expires.

What is required under this section is that the assessee has used the property for residence and non use of it by the assessee due some reasons will not disentitle him from eligibility under Section 54F. [Amit Gupta v. CIT (2006) 6 SC 403 (Del.)].

**5.55.7 CAPITAL GAIN ON SHIFTING OF INDUSTRIAL UNDERTAKING FROM URBAN AREA (SECTION 54G)**

Exemption under this section is available subject to satisfaction of the following conditions:

(i) A capital asset (being plant, machinery, land or building or any right in land or building) used for the purpose of an industrial undertaking situated in an urban area is transferred. For this purpose, „urban area“ means any such area within the limits of a municipal corporation or municipality as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purpose of this section.
(ii) The transfer is effected in the course of, or in consequence of, the shifting of such industrial undertaking (hereinafter referred to as the original asset) to any area other than an urban area.

(iii) The assessee has within a period of one year before or 3 years after the date on which the transfer took place:

(a) purchased new machinery or plant for the purposes of business of the industrial undertaking in the area to which the said undertaking is shifted;

(b) acquired building or land or constructed building for the purposes of his business in the said area;

(c) shifted the original asset and transferred the establishment to such area; and

(d) incurred expenses on such other purpose as may be specified in a scheme framed by the Central Government for the purposes of this section.

**How much exemption?**

If the conditions given above are satisfied the capital gains will be exempt to the extent as follows:

If the amount of the capital gain is greater than the cost and expenses incurred in relation to all or any of the purposes mentioned in clauses (a) to (d) (such cost and expenses being hereinafter in this section referred to as the new asset), the difference between the amount of the capital gain and the cost of the new asset shall be charged under Section 45 as the income of the previous year; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of 3 years of its being purchased, acquired, constructed or transferred, as the case may be, the cost shall be nil.

If the amount of the capital gain is equal to, or less than the cost of the new asset, the capital gain shall not be charged under Section 45; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of 3 years of its being purchased, acquired, constructed or transferred, as the case may be, the cost shall be reduced by the amount of the capital gain.

**Scheme of deposit**

Where the amount of capital gain is not appropriated or utilised by the assessee for purchase or construction of the new asset within one year before the date on which the transfer of the original asset took place or before the date of furnishing the return of income, it shall be deposited by him on or before the due date of furnishing the return of income, in an account with a bank or institution specified in and utilised in accordance with any scheme framed by the Central Government in this regard. The amount already utilised for purchase or construction of the new asset, together with the amount so deposited, shall be deemed to be the amount utilised for the purchase of a new asset. If the amount deposited is not utilised fully for purchase or construction of a new asset within the stipulated period, then the amount not so utilised shall be treated as the capital gain of the previous year in which the period of
3 years from the date of transfer of original asset expires. In such cases the assessee shall be entitled to withdraw such amount in accordance with the aforesaid scheme.

5.55.8 Exemption of capital gain on transfer of assets of shifting of industrial undertaking from urban area to a Special Economic Zone [Section 54GA]:

The exemption is available to all categories of assesses in respect of capital gain arising on the transfer of fixed assets other than furniture and fittings of industrial undertaking effected in the course of shifting of such industrial undertaking to any Special Economic Zone.

The conditions for claiming exemptions are as under:

(i) The transfer is effected in the course of or in consequence of shifting the undertaking from an urban area to any Special Economic Zone. The special Economic Zone may be developed in any urban area or any other area.

1. Any other area means an area not declared as an urban area.

2. "Urban Area" means any such area within the limits of a municipal corporation of municipality, as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purposes of this sub-section.

3. "Special Economic Zone" means each Special Economic Zone notified under the proviso to Sub-section (4) of Section 3 and Sub-section (1) of Section 4 of the Special Economic Zone Act, 2005 (including Free Trade and Warehousing Zone) and includes an existing Special Economic Zone. [Section 2(za) of the Special Economic Act, 2005].

(ii) Asset transferred is machinery, plant, building, land or any right in building or land used for the business of industrial undertaking in an urban area;

(iii) The capital gain arising on the asset transferred may be short-term or long-term capital gain. Normally, it will be short-term capital gain because most of the assets of the industrial undertaking will be depreciable assets;

(iv) The capital gain is utilized within 1 year before or 3 years after the date of transfer for the specified purpose.

Specified purpose includes the following:

(a) for purchase of new machinery or plant for the purpose of business of the Industrial Undertaking in the Special Economic Zone to which the said undertaking is shifted;

(b) acquisition of building or land or construction of building for the purposes of the assessee’s business in the Special Economic Zone;

(c) expenses on shifting of the old undertaking and its establishment to the Special Economic Zone; and

(d) incurring of expenditure on such other purposes as specified by the Central Government for this purpose.
5.55.9 EXTENSION OF TIME FOR ACQUIRING NEW ASSET OR DEPOSITING OR INVESTING AMOUNT OF CAPITAL GAIN (SECTION 54H)

Section 54H has been inserted by the Finance (No. 2) Act, 1991 with effect from 1.10.1991. This section states that where the transfer of the original asset is by way of compulsory acquisition under any law and the amount of compensation awarded for such acquisition is not received by the assessee on the date of such transfer, the period of acquiring the new asset by the assessee referred to in Sections 54, 54B, 54D, 54EC and 54F or for depositing or investing the amount of capital gain shall be extended. This extended period shall be reckoned from the date of receipt of such compensation.

5.56 BONUS SHARES AND CAPITAL GAINS

The Finance Acts 1994 and 1995 have brought about sweeping changes in computation of capital gains of shares. Cost of original shares is the actual price paid therefor. Cost of rights shares is the actual price paid therefor. Cost of bonus shares is nil. In other words, cost of original shares or rights shares will not rub off on to the bonus shares and its cost will be deemed to be nil as it is obtained free of cost just as cost of rights shares is not allowed to be influenced by the price paid for the original shares. In other words, from the assessment year 1996-97, there would be a compartmentalised approach to computation of capital gains in respect of shares with original shares and its offshoots i.e. rights and bonus remaining separate from one another. Any amount realised on relinquishment of rights will be taxable in full as cost of such relinquishment is also deemed to be nil.

5.57 COMPUTATION OF CAPITAL GAINS IN RESPECT OF DEPRECIABLE ASSETS (SECTION 50)

The capital gains on depreciable assets are computed as under:

1. Find out the written down value on the first day of the previous year relevant to the assessment year of all those depreciable assets on which the depreciation is allowed at the same rate. All such assets are known as ‘block of assets’.

2. If any new asset of the same block is purchased during the previous year, the cost of such asset shall be included in the balance at step (1).

3. If any asset is sold out of such block during the previous year, the net consideration shall be deducted from the balance under (2).

4. Computation of depreciation at the prescribed rate on the balance under (3) and deduction thereof from the same balance.

5. The balance under (4) shall be the written down value of the ‘block of assets’ for the next year.

It means if the net consideration of an asset out of the block is less than the balance under (2), there would be no capital gain. If the net consideration of an asset is more than the balance under (2) (the value of all assets in the block) the excess shall be deemed to be short term capital gain. If all the assets of the block are sold in the previous year and the net consideration is less than the balance under (2), the loss shall be deemed to be short-term capital loss.
Where subject matter of transfer is an asset on which deduction on account of depreciation under Section 32(1)(i) has been claimed and obtained by the assessee in any previous year, the cost of acquisition of the asset shall be the written down value as defined in Section 43(6).

5.58 COST OF ACQUISITION AND CAPITAL GAIN IN CASE OF DEPRECIABLE ASSETS OF ELECTRICITY COMPANIES [SECTION 50A]

Where the capital asset is an asset in respect of which an undertaking engaged in generation or generation and distribution of power has claimed depreciation at certain percentage on actual cost under Section 32(1)(i), in any previous year, than for purpose of computing capital gain on such assets, the cost of acquisition shall be the actual cost at which the asset was acquired by such undertaking and it shall not be the written down value as adjusted, as is applicable for other assessee's. However, on such transfer, the difference between the actual cost and the WDV of such asset shall be balancing charge taxable under Section 41(2). Further in this case, there can be long-term capital gains if the asset is held for more than 36 months.

5.59 SPECIAL PROVISIONS FOR COMPUTATION OF CAPITAL GAINS IN CASE OF SLUMP SALE [SECTION 50B]

Any profits or gains arising from the slump sale, effected in the previous year, shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place. However, if the undertaking is owned and held by the assessee for not more than 36 months immediately preceding the date of transfer, then such slump sale will result into short-term capital gain. On the other hand, if such undertaking is owned and held by the assessee for more than 36 months immediately preceding the date of transfer, it shall be deemed to be long-term capital gains irrespective of the fact that such undertaking has acquired certain assets which are held for less than 36 months.

Meaning of slump sale [Section 2(42C)]

'Slump sale' means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

In other words it is a sale where the assessee transfers one or more undertaking as a whole including all the assets and liabilities as a going concern. The consideration is fixed for the whole undertaking and received by the transferor it is not fixed for each of the asset of the undertaking as a whole by way of such sale.

Thus it may be noted that the undertaking as a whole or the division transferred shall be a capital asset.

5.60 COMPUTATION OF CAPITAL GAIN IN REAL ESTATE TRANSACTION [SECTION 50C]

Section 50C makes a special provision for determining the full value of consideration in cases of transfer of immovable property. It provides that where the consideration declared to be received or accruing as a result of the transfer of land or building or both, is less than the value adopted or assessed by any authority of a
State Government (i.e. "stamp valuation authority") for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed shall be deemed to be the full value of the consideration, and capital gains shall be computed on the basis of such consideration under Section 48 of the Income-tax Act.

5.61 REFERENCE TO VALUATION OFFICER (SECTION 55A)

With a view to ascertaining the fair market value of a capital asset, the concerned Assessing Officer may refer the valuation of the capital asset to a Valuation Officer appointed by the Income-tax Department in the following cases:

(a) Where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer (who works in a private capacity under a licence issued by the Board and his valuation is not binding on the Assessing Officer), but the Assessing Officer is of the opinion that the value so claimed is less than its fair market value [Section 55A(a)].

(b) Where the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset by more than ₹ 25,000 or 15 per cent of the value claimed by the assessee whichever is less [Section 55A(b)(i) read with Rule 111AA].

(c) Where the Assessing Officer is of the opinion that, having regard to the nature of an asset and relevant circumstances, it is necessary so to make a reference to the Valuation Officer [Section 55A(b)(ii)].

It may be noted that in a case where the assessee has opted for substitution of the cost of acquisition of an asset by its fair market value as on 1.4.1981, the fair market value as claimed by him may be higher than its actual fair market value. The provisions of Section 55A(a) and (b)(i) are, therefore, not applicable to such a case. It is, however, open to the Assessing Officer to make a reference to the Valuation Officer under Section 55A(b)(ii). The Central Government has appointed a large number of Valuation Officers under Section 12A of the Wealth-tax Act and these Valuation Officers exercise their functions in relation to the categories of asset for which they have been appointed. The jurisdiction of the Valuation Officers has been defined in Rule 3A of the Wealth-tax Rules. The Valuation Officer exercise the same jurisdiction for income-tax purposes also.

Note that in cases covered by Section 55A(a) and (b)(i) above it is the duty of the Assessing Officer to refer the valuation of the capital asset in question to the Valuation Officer attached to the department and not to decide the question of the valuation on his own.

Illustration:

A has the following incomes for the previous year 2011-12:

- Business income: ₹(-) 30,000 (viz. business loss of 30,000)
- Short-term capital gains: ₹6,000
- Long-term capital gains: ₹1,90,000
A deposits ₹ 9,000 in public provident fund account. You are required to find out his tax liability for the assessment year 2012-13.

Solution:

Computation of net Income of Mr. A for the assessment year 2012-13

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Income</td>
<td>₹ 30,000</td>
<td></td>
</tr>
<tr>
<td>Capital gain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Short-term</td>
<td>₹ 6,000</td>
<td></td>
</tr>
<tr>
<td>- Long-term</td>
<td>₹ 1,90,000</td>
<td>₹ 1,96,000</td>
</tr>
<tr>
<td></td>
<td>₹ 1,66,000</td>
<td></td>
</tr>
</tbody>
</table>

Computation of Tax Liability for the assessment year 2012-13

<table>
<thead>
<tr>
<th>Income other than long-term capital gain (a)</th>
<th>Long-term capital gain (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>₹ (a)</td>
<td>₹ (b)</td>
</tr>
<tr>
<td>(–) 24,000</td>
<td>1,90,000</td>
</tr>
<tr>
<td>Tax on (a)</td>
<td>Tax on (b)</td>
</tr>
<tr>
<td>Nil</td>
<td>₹ 2,060</td>
</tr>
</tbody>
</table>

Notes:

1. If the net income (other than long-term capital gain) is below the amount of first slab which is not taxable (i.e. ₹ 1,80,000), then the long-term capital gain is to be reduced by the amount by which the total income (other than long-term capital gain) falls short of the maximum amount which is not chargeable tax.

In this case, net income (other than long-term capital gain is (–) ₹24,000 which will be allowed for carried forward i.e. not to be deducted from ₹1,80,000. Therefore, long-term capital gain shall be reduced by ₹ 1,80,000. Thus tax on long-term capital gain ₹ 10,000 (viz. ₹ 1,90,000 – 1,80,000) @ 20.6% including education cess is ₹ 2,060.

PART V: INCOME FROM OTHER SOURCES

5.62 INCOME CHARGEABLE UNDER THE HEAD „INCOME FROM OTHER SOURCES“

Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier must be charged to tax as „income from other sources”. This head is thus a residuary head of income under which income can be computed only after deciding whether the particular item of income is otherwise assessable under any of the first four heads. In addition to the taxation of income not covered by the other heads, Section 56(2) specifically provides certain items of incomes as being chargeable to tax under the head in every case.
Such incomes are:

(a) **Dividends [Section 56(2)(i)].**

Current profit would be part of accumulated profits but subsidiary on capital account cannot be treated as accumulated profits. [CIT v. Rajasthan Wires (P) Ltd. (2003) 130 Taxman 93 SP (Mag.).]

(b) **Keyman Insurance policy**

Amount received under a Keyman insurance Policy, including bonus on each Policy, if it is not taxable under any other head of income.

(c) **Winnings from lotteries [Section 56(2)(ib)]:**

Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature.

(d) **Contribution to Provident fund**

Income of the nature referred to in Section 2(24)(x) (relating to certain contributions to any provident fund or superannuation fund or any fund set up under the provisions of the ESI Act or any other fund for the welfare of such employees received by the assessee from his employees in his capacity as an employer) will be chargeable to income-tax under the head "income from other sources" if such income is not chargeable to income-tax under the head "profits and gains of business or profession". But if the employer deposits such amount on or before due date of deposit applicable for such contribution, he will be allowed a deduction on account of the same. [Section 56(2)(ic)].

(e) **Income by way of interest on securities:**

If the income by way of interest on securities is not chargeable to income-tax under the head "Profits and gains of business or profession".

(f) **Income from hiring machinery etc. [Section 56(2)(ii)]:**

Income from machinery, plant or furniture belonging to the assessee and let on hire if the income is not chargeable to income-tax under the head "Profits and gains of business or profession".

(g) **Hiring out of building with machinery etc. [Section 56(2)(iii)]:** Where an assessee lets on hire machinery, plant or furniture belonging to him and also building and the letting of the building is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income-tax under the head "Profits and gains of business or profession".

(h) **Money Gifts:**

Where any sum of money, the aggregate value of which exceeds fifty thousand rupees, is received without consideration, by an individual or a Hindu undivided family, in any previous year from any person or persons on or after the 1st day of April, 2006 but before 1st day of October, 2009, the whole of the aggregate value of such sum [Section 56(2)(vi)]
Provided that this clause shall not apply to any sum of money received
(a) from any relative; or
(b) on the occasion of the marriage of the individual; or
(c) under a will or by way of inheritance; or
(d) in contemplation of death of the payer; or
(e) from any local authority as defined in the Explanation to clause (20) of section 10; or
(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or
(g) from any trust or institution registered under section 12AA.

Explanation: For the purposes of this clause, relative means
(i) spouse of the individual;
(ii) brother or sister of the individual;
(iii) brother or sister of the spouse of the individual;
(iv) brother or sister of either of the parents of the individual;
(v) any lineal ascendant or descendant of the individual;
(vi) any lineal ascendant or descendant of the spouse of the individual;
(vii) spouse of the person referred to in clauses (ii) to (vi).

(i) Gifts in Cash or in Kind:
where an individual or a Hindu undivided family receives, in any previous year, from any person or persons on or after the 1st day of October, 2009
(Section 56(2)(vii)
(a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;
(b) any immovable property, without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property.
(c) any property, other than immovable property
(i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;
(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration:

Provided that where the stamp duty value of immovable property as referred to in subclause (b) is disputed by the assessee on grounds mentioned in sub-section (2) of section 50C, the Assessing Officer may refer the valuation of such property to a Valuation Officer, and the provisions of section 50C and sub-section (15) of section 155 shall, as far as may be, apply in relation to the stamp duty value of such property
for the purpose of sub-clause (b) as they apply for valuation of capital asset under that section:
Provided further that this clause shall not apply to any sum of money or any property received
(a) from any relative; or
(b) on the occasion of the marriage of the individual; or
(c) under a will or by way of inheritance; or
(d) in contemplation of death of the payer or donor, as the case may be; or
(e) from any local authority as defined in the Explanation to clause (20) of section 10; or
(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or
(g) from any trust or institution registered under section 12AA.

Explanation:
(a) "fair market value" of a property, other than an immovable property, means the value determined in accordance with the method as may be prescribed;
(b) "property" means the following capital asset of the assessee, namely:
   (i) immovable property being land or building or both;
   (ii) shares and securities;
   (iii) jewellery;
   (iv) archaeological collections;
   (v) drawings;
   (vi) paintings;
   (vii) sculptures; or
   (viii) any work of art or
   (ix) bullion
(c) "stamp duty value" means the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property;

(J) Shares as gift:
where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year, from any person or persons, on or after the 1st day of June, 2010, any property, being shares of a company not being a company in which the public are substantially interested, [Section 56(2)(viia)]
   (i) without consideration, the aggregate fair market value of which exceeds
fifty thousand rupees, the whole of the aggregate fair market value of such property;

(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration:

Provided that this clause shall not apply to any such property received by way of a transaction not regarded as transfer under clause (via) or clause (vic) or clause (vicb) or clause (vid) or clause (vii) of section 47.

(k) **income by way of interest received on compensation** or on enhanced compensation referred to in clause (b) of section 145A.] [Section 56(2)(viii)].

---

**Winnings from lotteries, cross-word puzzles, races, (including horse races), card games and other games of any sort or from gambling or betting of any form or nature whatsoever, are specifically chargeable to tax as income from other sources even if the assessee deriving such income claims to carry on any trade or adventure in these activities as part of his business.**

The entire income of winnings, without any expenditure or allowance or deductions under Sections 80C to 80U, will be taxable. **However, expenses relating to the activity of owning and maintaining race horses are allowable.** Further, such income is taxable at a special rate of income-tax i.e., 30% + surcharge + cess @ 3% [Section115BB]

Besides the above, **there are some other incomes which are also chargeable under the head „Income from Other Sources”.** For example:

1. Any fees or commission received by an employee from a person other than his employer.
2. Any annuity received under a Will. It does not include an annuity received by an employee from his employer.
3. All interest other than interest on securities, e.g. interest on bank deposits, interest on loan, etc.
4. Income of a tenant from sub-letting the whole or a part of the house property.
5. Remuneration received by a teacher or a lawyer for doing examination work.
6. Income of Royalty.
7. Director’s fees.
8. Rent of land not appurtenant to any building.
9. Agricultural Income from land situated outside India.
10. Income from markets, ferries and fisheries, etc.
11. Income from leasehold property.
12. Remuneration received for writing articles in Journals.
(13) Income from undisclosed sources.
(14) Interest received by an employee on his own contributions to an unrecognised provident fund.
(15) Casual income in excess of ₹ 5,000, or (₹ 2,500 in case of winning from horse race, etc.) as the case may be.
(16) Salary of a Member of Parliament, Member of Legislative Assembly or Council.
(17) Interest received on securities of co-operative society.
(18) Family pension received by the widow of an employee of the U.N.O. is exempt. Similarly the family pension of gallantry awardee is exempt.
(19) Amount withdrawn from deposit in National Savings Scheme, 1987 on which deduction under Section 80CCA has been allowed including interest thereon.
(20) Gratuity received by a director who is not an employee of the company.
(21) Director’s commission for giving guarantee to bank.
(22) Director’s commission for underwriting shares of a new company.

Further, under the provisions of Sections 60 to 65 an assessee may be chargeable to tax in respect of income arising to other persons, e.g. spouse or minor children. In such cases, the income in question will be first computed under the appropriate head after allowing various deductions and includible in the total income of the assessee under the head “income from other sources”. In other words, wherever the assessee is taxable in respect of income of some body else, the income must be charged to tax in the hands of the assessee only under this head even if the income is of a character which would otherwise fall for assessment under any other head of income.

5.63 TAXATION OF DIVIDENDS

Section 10(34) exempts dividend as defined in Section 115-O from tax in the hands of recipients thereof. Section 115-O, the main operative provision in the newly introduced Chapter XII-D, however, calls upon a company declaring/distributing dividend to pay 15% plus surcharge plus Education & Secondary and Higher Education Cess by way of tax on distributed profits in addition to what it is liable by way of tax on its income in the normal course. This tax on distribution paid by a company is not available for deduction under any provision of the Act. Dividend for the purpose of Section 115-O and by extension for the purpose of Section 10(33) is the same as defined in Section 2(22) except that clause (e) thereof shall not be treated as dividend for both these purposes. In other words the scheme of taxation of dividend can be summarised as under:

(a) Dividends or any other income distributed by UTI or a foreign company, are chargeable to tax under this head.

(b) In respect of dividend under clause (e) of Section 2(22) the status quo continues i.e. the specified persons receiving loans and advances from a closely-held company will continue to pay tax as earlier on these receipts and the company giving such loans and advances will not be liable to tax like it
was earlier. It may be pointed out that tax liability under clause (e) of Section 2(22) would be extremely unlikely now that there is no need for the dominant shareholders of closely-held companies to combine dividend with the character of loan or advance to avoid tax liability because dividend is no longer taxable in the hands of shareholders. Against this backdrop, the discussion hereunder may be studied.

Meaning of the term "Dividend" [Section 2(22)]

The term 'dividend' is ordinarily used to refer to any distribution made by a company to its shareholders out of its profits in proportion to the number of shares held by the shareholder concerned in the company. Apart from the distribution made by the company, any division of profit between the members who earned the same would also be treated as dividend under the general meaning of expression. For purposes of income-tax, the definition of dividend is given in Section 2(22) of the Income-tax Act. The definition, although not exhaustive and comprehensive, is having the effect of over-riding anything else to the contrary contained in any other law for the time being in force. The definition given in the Income-tax Act is enumerative and inclusive in nature and does not precisely specify as to what exactly is meant by the term dividend. Consequently, any money received by a shareholder which may not fall within the various items specified in the Income-tax Act may still be considered and taxable as dividend except in cases where a different interpretation or inference could be had in the circumstances of the case.

According to the definition in the Income-tax Act, 'Dividend' includes the following items:

(a) Any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

Current profit would be part of accumulated profits but subsidy on Capital Account cannot be treated as accumulated profits. – CIT v. Rajasthan Wires (P) Ltd. (2003) 130 Taxman 93 DP (Mag.).

(b) Any distribution, by a company to its shareholders, of debentures debenture stock or deposit certificates in any form, whether with or without interest and any distribution to its preference shareholders of shares by way of bonus to the extent to which the company possesses accumulated profits, whether capitalised or not;

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

(d) Any distribution to its shareholders by a company on the reduction of its share capital, to the extent to which the company possesses accumulated profits, whether capitalised or not;

(e) Any payment made by a company, in which the public are not substantially interested of any sum whether representing a part of the assets of the company or otherwise made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or
without right to participate in profits), holding not less than ten per cent of the
voting power, or to any concern in which such shareholder is a member or a
partner and in which he has a substantial interest (hereinafter in this clause
referred to as the said concern), or any payment by any such company on
behalf of or for the benefit of the shareholder having substantial interest in
the company to the extent to which the company possesses accumulated
profits.

But, Sub-section (22) to Section 2 specifically excludes the following:

(i) Any distribution made by a company in accordance with (c) or (d) above in
respect of any share issued for full cash consideration in cases where the
shareholder is not entitled, in the event of liquidation, to participate in the
surplus assets of the company;

(ii) Any distribution made in accordance with items (c) and (d) above in so far the
distribution is attributable to the capitalised profits of the company
representing bonus shares allotted to its equity shareholders after 31.3.1964
and before 1.4.1965;

(iii) Any advance or loan made by a company to its shareholder the said concern,
i.e., a HUF firm, an AOP or, BOI or a company in the ordinary course of its
business in cases where lending of money is a substantial part of the
business of the company;

(iv) Any dividend paid by a company which is set off by the company against the
whole or any part of any sum previously paid by it and treated as a dividend
under item (e) above to the extent to which it is so set off;

(v) Any payment made by a company on purchase of its own shares from a
shareholder in accordance with the provisions of Section 77A of the
Companies Act, 1956;

(vi) Any distribution of shares pursuant to a demerger by the resulting company
to the shareholders of the demerged company (whether or not there is a
reduction of capital in the demerged company).

The enumeration given above represents various payments which are notionally
or by fiction of law, treated as dividend and which, in the absence of specific provision
may not be chargeable to tax as dividend income in the hands of shareholders. The
distributions or payments constituting dividend referred to above apply only to
payments or distributions made by a company as defined in Section 2(17) of the
Income-tax Act.

Since the meaning and scope of the term ‘dividend’ used in the income-tax Act is
much wider than what is commonly understood, it covers not only payments as
dividends made by a company in accordance with the provisions of company law but
also various other payments which may not amount to dividend under company law.
In order to be chargeable to tax as dividend, it is not essential that the dividend must
be paid only in cash although the provisions of Company Law require that a dividend
must always be paid in cash or by cheque. In all cases where a dividend is paid in
any form other than cash, say in the form of goods, securities or shares, even of
another company, the amount of dividend which is liable to income-tax must be taken
to be the market value of the thing received as dividend.
For instance, if company A distributes dividends to its shareholders in the form of shares of its wholly owned subsidiary company B at the face value of ₹ 100 each while the market value is ₹ 150 per share, the liability to tax on the part of the company would be on the basis of the market value of the share. For this purpose, it is immaterial if the shares are such that a part of the shares cannot be divided for being utilized towards tax deductible at source. The company’s liability to pay distribution tax is not in any way affected or reduced by the fact that the dividend in question is paid in kind or is calculated on a basis different from what the income-tax law provides.

It is likely that the company may not comply with some of the provisions of Company Law in the matter of declaration and payment of dividends. Even in such cases, non-observance of the various formalities or the provisions of Company Law by the company concerned would not in any way affect the taxability of the amount as dividend in the hands of the Company. Consequently, if a company, in violation of law, distributes dividends out of its share premium account, the Company would still be taxable regardless of the fact that the payment in question does not come out of the revenue profits of the declaring company.

In the process of capitalisation of the accumulated profits and reserves, a company may normally resort to the issue of bonus shares. This is mostly done in cases when a company is prosperous and has a large surplus and after some time it is decided to convert the surplus into capital and divide the capital amongst the members in proportion to their rights. This is done by issuing fully paid shares representing the increased share capital. Bonus shares are issued out of credit balance to the Profit and Loss Account and out of reserves and the shareholders to whom the shares are issued, have to pay nothing. The purpose is to capitalise profits which may be otherwise available for distribution. If the Articles of Association of a company permit, a company can capitalise profits and reserves and issue fully paid shares on a nominal value equal to the amount capitalised to its shareholders. This is permissible subject, however, to the provisions of Sections 78 and 205 of the Companies Act and guidelines issued in this regard by the SEBI.

When bonus shares are issued by a company to its equity shareholders the company is not chargeable to distribution tax on the value of the bonus shares. This is because of the fact that according to Section 2(22)(a), the distribution of accumulated profits of a company would result in dividend only if there is release of the company’s assets as a result of such distribution. This is because of the fact that the effect of the bonus issue is that the profits remain in the hands of the company as capital and the shareholders receive only paper certificates as evidence of their interest in the additional capital so set aside or capitalised. The transaction takes nothing out of the company’s coffers and puts nothing into the shareholders’ pockets and the only result is that the company which, before the resolution, could have distributed the profits by way of dividend or carried it to a reserve account, comes under an obligation to retain it permanently as its capital. Therefore, bonus shares given by a company in proportion to the holding of equity capital by a shareholder are, in the absence of any express provision to the contrary, not liable to be taxed as income. Therefore, bonus shares are not dividend or income at all when they are issued to the holders of equity or ordinary shares.

However, the utilisation of the accumulated profits for the purpose of starting a
subsidiary company and issue of shares of the subsidiary company to its own shareholders as bonus shares would constitute dividend, as there would be a release of assets by the parent company.

In cases where bonus shares are issued to the holders of preference shares, the market value of the bonus shares would be liable to distribution tax as income by way of dividends in the hands of the Company in view of the specific provisions contained in Section 2(22)(b). However, even in the case of preference shareholders, the liability to tax would be only to the extent to which the distribution is made by the company out of its accumulated profits, whether capitalised or not.

Any distribution made by a company out of its accumulated profits would constitute dividend if the distribution is made on the reduction of share capital of the company. This reduction may take place even in cases where bonus shares are issued by capitalising the accumulated profits and reserves of the company and later on paying off the bonus shares. This may also take place in cases where the accumulated profits are applied first towards making the partly-paid shares into fully-paid ones and later, the amount of the fully-paid shares is reduced on reduction of share capital. Even in the case of liquidation of a company, any distribution made by the liquidator (less than the capital subscribed) would constitute income from dividend to the extent to which the distribution could be attributable to the accumulated profits of the company which may or may not have been capitalised during the existence of the company.

The ‘accumulated profits’ for the purpose do not include any capital gain arising to the company before 1.4.1946 or after 31.3.1948 and before 1.4.1956 because during these periods capital gains were not chargeable to tax and were consequently not treated as part of the profits of the company. In the case of every company, the expression accumulated profits must be taken to include all profits of the company up to the date of distribution or payment including reserves kept for specific purposes so long as such reserves constitute an appropriation of profit instead of being a charge against profit. For instance, amount represented by the balance to the credit of the development rebate reserves account would form part of the accumulated profits of the company; but if a company follows the process of crediting the amount of depreciation reserve account such a reserve would not form part of the accumulated profits of the company because depreciation is a charge against the profits and not an appropriation of profits. In the case of a company in liquidation, accumulated profits should be taken to include all the profits of the company up to the date of liquidation. But in cases where the liquidation is consequent upon the compulsory acquisition of its undertaking by a government or a corporation owned or controlled by the government under any law for the time being in force, accumulated profits should not be taken to include any profits of the company prior to three successive accounting years immediately preceeding the accounting year in which such acquisition of the company was made by the government or other statutory corporation.

Any payment of loan or other advance by a company, in which the public are not substantially interested, to its shareholder who has substantial interest in the company would constitute dividend to the extent to which the company possesses accumulated profits which may or may not have been capitalised. Similarly, any payment made by a closely held company for the individual benefit of a shareholder
who has a substantial interest in the company would also constitute dividend chargeable to tax in the hands of the shareholder. For instance, if a closely held company makes payment of insurance premium on behalf of the shareholder or lends money to the shareholder or makes any advance on his behalf, the shareholder would be deemed to have received a dividend and be chargeable to income-tax thereon. The expression ‘shareholder’ for this purpose should be taken to mean only the registered shareholder and not the beneficial shareholder. Consequently in cases where the loans are given by a closely held company to a Hindu Undivided Family of which the registered shareholder is a member, such loans would not be taxable as dividend since the Hindu Undivided Family is not registerable as shareholder of the company. If, however, the loans are advanced to the registered shareholders, the loans would be taxable as dividend even though the registered shareholder may not have any personal or beneficial interest in the shares concerned. The liability to tax in respect of such loans, advances, other payments made by a closely held company to its substantial shareholder, would be only to the extent to which the company possesses accumulated profits, which may or may not have been capitalised.

In the case of CIT v. V. Damodaran (1980) 121 ITR 572, the Supreme Court held that ‘accumulated profits’ cannot include current profits, and therefore, the profits earned by the company during the year in which loans are advanced to a shareholder cannot be regarded as accumulated profits for deemed dividends. Therefore, if the company at the time of giving the loan or making the advance does not have any accumulated profit, there would be no liability to tax because of the specific exemption given in the section. Similarly, any loan by a closely held company to its substantial shareholder which is set off against any loan or money borrowed by or due to the company from the shareholder would also be not liable to income-tax as dividend. In cases where a company possesses accumulated profits and loans are given to the shareholder, the liability to tax on the part of the shareholder would not be restricted to the amount of the accumulated profits in proportion to his shareholding in the company. Thus, if a company has accumulated profits of ₹1,00,000 and a shareholder holding 20% of the equity shares is given a loan of ₹80,000, the shareholder cannot claim that his liability to tax would by only to the extent of ₹20,000, he would be taxable on the entire amount of loan received from the company although if the company had declared dividend at an Annual General Meeting, he would have been entitled to receive a maximum of ₹20,000 only.

In conclusion it may be conducive to easy memory to summarize as under:

— the types of dividend contemplated by the first four clauses viz. (a) to (d) of Section 2(22) are exempt in the hands of the shareholders.

— the last category viz. 2(22)(e) which has applicability only to the shareholders of closely-held companies or dividend from a foreign company, be taxable in the hands of shareholders.

5.64 DEDUCTIONS ALLOWABLE IN COMPUTING INCOME FROM OTHER SOURCES

The income chargeable under the head “Income from other sources” is the income after making the following deductions:

1. From interest on securities [Section 57(i) and (iii)]: any reasonable sum
paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest on behalf of the assessee. Interest on money borrowed for investment in securities can be claimed as a deduction.

During the previous year the assessee withdrew a fixed deposit before maturity and had to refund ₹ 3,500 to the bank. The amount withdrawn was invested in shares. It was held by Karnataka High Court under the earlier regime that the amount paid to the Bank was an expenditure laid out wholly and exclusively for the purpose of earning the dividend income and deduction thereof while computing income from dividend is in order. C.I.T. v. Master Sabraya M. Pai (1984) 150 ITR 251 (Kar.).

2. From the contributions received by employer from employees towards P.F./Superannuation/other funds: [Section 57(ia)]

In the case of income of the nature referred to in Section 2(24)(x), which is chargeable to income-tax under the head ‘Income from other sources’ deduction shall be allowable in accordance with the provisions of Section 36(1)(va), i.e., if the employer has credited the employee’s accounts in the respective funds with the amounts of contributions received, the employer shall be allowed credit thereof.

3. Income derived from letting [Section 57(ii)]: Where income is derived from letting out of machinery, plant or furniture on hire and also buildings where the letting of building is inseparable from the letting of such machinery, plant or furniture and the income from such letting is not chargeable to Income-tax under the head ‘Profits and Gains of Business or profession’, the following expenses incurred in respect of those assets:

(a) Current repairs of buildings.
(b) Insurance premium against risk of damage or destruction of the premises.
(c) Repairs and insurance of machinery, plant or furniture.
(d) Depreciation.

Where the expenses referred to at (a) to (d) hereinabove are incurred on property used partly for the business of the assessee, a proportionate deduction shall be allowed.

4. Income in the nature of family pension [Section 57(iia)]: Where a regular monthly amount is payable by an employer to a person belonging to the family of an employee in the event of his death, i.e., ‘family pension’, a sum equal to 33-1/3% of the income or ₹ 15,000, whichever is less, is allowable as a deduction.

All these expenses will be allowed only when the prescribed particulars are furnished by the assessee.

5. Other deductions [Section 57(iii)]: Any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income. [Smt. Virmati Ramkrishna v. C.I.T. (1981) 131 ITR 659(Guj)]

6. Interest on compensation or enhanced compensation [Section 56(2)(viii)]: a deduction of a sum equal to 50% of such income and no deduction shall be allowed under any other clause of this section.

Deductions under this clause will, therefore, be allowed only if the following
conditions are satisfied:
(a) The expenditure is laid out wholly and exclusively for the purpose of earning such income. If the purpose of earning income is coupled with some other extraneous purpose, it will not be possible to say that the deduction under Section 57 (iii) is earned by the assessee. [Smt. Padmavati Jaykrishna v. C.I.T. (1975) 101 ITR 153].
(b) It is not in the nature of capital expenditure.
(c) It is not a personal expenditure.
(d) It is incurred in the accounting year itself and not in any prior or subsequent year. [C.I.T. v. Basant Rai Takhat Singh (1922) ITR 197].

The section does not say that the expenditure shall be deductible only if income is made or earned. Interest on moneys borrowed for investment in shares which had not yielded any income was admissible as a deduction under the section. [C.I.T. v. Gopal (1978) 111 ITR 86].

Note: In computing the income by way of dividends of a foreign company, no deduction will be allowed under Section 57.

5.65 AMOUNTS NOT DEDUCTIBLE (SECTION 58)

The following amounts shall not be deducted in computing income chargeable under the head ‘Income from other sources’:

In the case of any assessee:
(i) Any personal expenses of the assessee.
(ii) Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.
(iii) Any payment which is chargeable under the head ‘Salaries’ if it is payable outside India unless tax has been paid thereon or deducted therefrom at source.
(iv) Any expenditure referred to in Section 40A of Income-tax Act.

Section 58(3) lays down that in the case of a foreign company, the provisions of Section 44D will apply while computing income under this head.

No deduction is allowed in respect of any expenditure or allowance in computing the income by way of winnings from lotteries crossword puzzles races (including horse races) card games and other games of any sort or from gambling or betting of any form or nature whatsoever. The prohibition however will not apply in respect of income of an assessee who is owner of horses maintained for running in horse races [Section 58(4)]. The winnings are now taxed at the rate of 30%. The amount is taxable at source and it does not matter whether amount goes to one or more recipients. Similarly the amount spent in buying of infructuous tickets is not deductible as the gross amount will be taxed.
5.66 TAX CONCESSIONS

The word "security" has not been defined by the Income-tax Act. Therefore, its natural meaning as well as the meaning, as interpreted in the case laws, has to be adopted.

The Shorter Oxford English Dictionary defines "security" as: "a document held by a creditor as guarantee of his right to payment. This implies that unless the payment of debt is secured in some way, a mere "debt" is not a security.

In Singer v. Williams (1921) 1 AC 41, Lord Cave pointed out that the word "security" denotes a debt or claim, the payment of which is in some way secured. Where the word is used in its normal sense, some form of secured liability is postulated. The word "securities" must be construed in the above defined sense and does not include shares or stock in a company".

The basis of charge on income by way of interest on securities is on "receipt" basis if books of account are maintained on cash basis. If the assessee does not maintain books of account or, when he maintains books of account on the basis of "mercantile system", it is taxable on "due" basis.

A. Exempted Interest [Section 10(4)]

(i) In the case of a non-resident, any income by way of interest on the securities or bonds notified by the Central Government in the Official Gazette, including income by way of premium on the redemption of such bonds.

No securities or bonds will be specified by the Central Govt. for this purpose on or after 1.6.2002.

(ii) In case of an individual any income by way of interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1973 and the Rules made thereunder.

Provided that such individual is a person resident outside India as defined in Section 2(q) of the said Act or is a person who has been permitted by the Reserve Bank of India to maintain such account.

B. Exempted Interest [Section 10(15)]

The interest income from the following securities enumerated specifically at clause 15 of Section 10 of the Income-tax Act is exempted. Hence, the interest thereon shall not be included in the income of the assessee.

(i) Income by way of interest, premium on redemption or other payment on such securities, bonds, annuity certificates, savings certificates, other certificates issued by the Central Government and deposits as the Central Government may, by notification in the Official Gazette, specify in this behalf, subject to such conditions and limits as may be specified in the said notification.

(ii) In the case of an individual or a Hindu Undivided family, interest on such Capital Investment Bonds as the Central Government may, by notification in
In the case of an individual or a Hindu Undivided family, interest on the notified Relief Bonds.

In the case of: (a) a non-resident Indian, being an individual owning the bonds; or (b) a nominee or survivor of the non-resident Indian; or (c) the donee, being an individual, to whom the bonds have been gifted by the non-resident Indian, the interest received thereon shall be exempt if the bonds are purchased by the non-resident Indian, in foreign exchange and the interest and principal received thereon, whether on maturity or otherwise, is not allowed to be taken out of India. The benefit does not cease even if the non-resident Indian subsequently acquires the status of a resident. But, in the event of premature encashment thereof, the benefit shall cease from the previous year in which the encashment is made.

Interest on securities held by the Issue Department of the Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1949.

Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country or any deposits made by it, with the approval of the RBI, with any scheduled bank.

Interest payable by Government or a local authority on moneys borrowed by it before June 1, 2001 from or debts owed by it to sources outside India.

Interest payable by an industrial undertaking in India on moneys borrowed by it before June 1, 2001 under a loan agreement entered into with such financial institution in a foreign country as may be approved in this behalf by the Central Government by general or special order.

Interest payable by an industrial undertaking in India on any moneys borrowed or debt incurred by it before June 1, 2001 in a foreign country in respect of purchase outside India of raw materials or components or capital plant and machinery to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf having regard to terms of the loan or debt and its repayment. Purchase, includes Hire Purchase Agreement or a lease agreement with an option to purchase such plant and machinery.

Interest payable by the Industrial Finance Corporation of India or the IDBI or the Industrial Credit and Investment Corporation of India or Export-Import Bank of India, or the National Housing Bank or the Small Industries Development Bank of India on any moneys borrowed before June 1, 2001 from sources outside India.

Interest payable by any other financial institutions established in India or a banking company on any moneys borrowed before June 1, 2001 from sources outside India under an approved loan agreement.

Interest at the rate approved by the Central Govt. payable by an industrial undertaking in India on any moneys borrowed by it in foreign currency from sources outside India under an approved loan agreement.
(ivfa) Interest payable by a scheduled bank to a non-resident or a person not ordinarily resident on deposits in foreign currency where the acceptance of such deposits by the bank is approved by the Reserve Bank of India.

(ivg) Interest payable by a public company formed and registered in India, and eligible for deduction under Section 36(1)(viii) with the main objective of carrying on business of providing long term finance for construction or purchase of houses in India for residential purposes on any moneys borrowed by it in foreign currency from sources outside India under an approved loan agreement before the 1st day of June, 2003, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government.

(ivh) Interest payable by public sector companies on certain specified bonds and debentures subject to such conditions, including the condition that the holder of such bonds or debentures registers his name and the holding with that company, as may be specified by the Central Government by notification in the Official Gazette.

(ivj) Interest payable by Government on deposits made by an employee of the Central or State Government, or a public sector company out of moneys due to him on account of his retirement, whether on superannuation or otherwise. To be eligible for exemption, the deposit must have been made by the employee in accordance with a scheme notified by the Central Government.

(ivj) Interest on securities held by the Registrar, Supreme Court, in Reserve Bank’s SGL Account No. SL/DHO48.

C. Assessees outside the scope of tax liability in respect of Interest on Securities

Where the securities are held by any of the following persons, interest thereon shall not be included in their income for income-tax purposes:

(i) Any authority constituted in India for the purpose of dealing with and satisfying the need for housing accommodation or for the purposes of planning, development or improvement of cities, towns and villages [Section 10(20A)].

(ii) Approved scientific research association [Section 10(21)].

(iii) Approved games associations or institutions [Section 10(23)].

(iv) Any Regimental Fund or Non-public Fund [Section 10(23AA)].

(v) An institution existing solely for the development of Khadi or Village industries [Section 10(23B)].

(vi) Authority established for the development of Khadi and Village Industries [Section 10(23BB)].

(vii) Any body or authority constituted for the administration of public religious trusts or endowments [Section 10(23BBA)].

(viii) European Economic Community [Section 10(23BBB)].
(ix) — The Prime Minister’s National Relief Fund; or
— The Prime Minister’s Fund (Promotion of Folk Art); or
— The Prime Minister’s Aid to Students Fund; or
— The National Foundation for Communal Harmony; or
— any university or other educational institution existing solely for educational purposes and not for purposes of profits, which is wholly or substantially financed by the government; or
— any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for the purposes of profits and which is wholly or substantially financed by the government; or
— any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed; or
— any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit, if the aggregate annual receipts of such hospital or institution do not exceed the amount of annual receipts as may be prescribed; or
— the income of notified funds or institutions established for charitable purposes; or
— notified trusts or institutions established wholly for public religious or public religious and charitable purposes; or
— any other approved university or other educational institution existing solely for educational purposes and not for the purposes of profit; or
— any approved hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation existing solely for philanthropic purposes and not for the purposes of profit, shall be exempt, subject to the fulfilment of the conditions specified in the sub-clauses (iv) and (v) inserted in Sub-section 10(23C) by the Direct Tax Laws (Amendment) Act, 1989.

(x) Any income received by the trustees of statutory provident fund, recognised provident fund, approved superannuation fund and approved gratuity fund [Section 10(25)].

(xi) Any income of a member of a scheduled tribe [Section 10(26)].

(xii) Any income (subject to fulfillment of certain requirements) of any person in the District of Ladakh or outside India (Section 26A).
(xiii) Any income of a corporation or other body or institution established for promoting the interest of the members of scheduled castes/scheduled tribes (Section 10(26B)).

(xiv) Any income of a public charitable and religious trust or institution (Section 11).

LESSON ROUND UP

- This is an exhaustive chapter containing computation of income under various heads dealing with intricate issues under respective heads.
- Allowances and deductions under respective heads are discussed in great detail in lucid manner.
- Relevant case laws and illustrations are given in appropriate places to clarify any provision under the Act.
- The chapter is divided into four parts dealing with each particular head of income.
- For the benefit of the students, at the end of some parts of this chapter procedure is spelt out for computing income under respective heads.

SELF TEST QUESTIONS

1. Define as per section 17 of the Income tax act, 1961:
   (a) Salaries, (b) Perquisites, (c) Profits in lieu of salary
2. Give the rules regarding the valuation of the following perquisites with suitable illustrations:
   (a) Rent-free house
   (b) Gas, Electricity, water, etc.
3. What are the various deductions allowed under the head salaries?
4. What are the provisions regarding exemption of House Rent Allowance?
5. Describe the different kinds of provident funds of which a salaried employee may be a member and state the Income Tax provisions regarding each.
6. State the types of savings covered under section 80C of the act and the quantum/maximum ceiling of tax rebate available under the said section.

7. (a) What is the meaning of 'Owner of House Property' under Section 27 of the Income-tax Act, 1961?

(b) What is 'annual value' of house property? How is it computed?

8. In computing the income from house property what deductions are allowed from the net annual value?

9. 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?

10. 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.

11. How will you compute income from Business or Profession?

12. Explain the following:

(a) 'Actual cost'.

(b) Written down value in view of the law regarding depreciation.

13. Discuss the provisions in regard to the following:

(i) Tax audit.

(ii) Bad Debts Reserve.

14. Write short notes on:

(i) Expenditure on Scientific Research.

(ii) Expenditure on Acquisition of Patents or copy rights.

(iii) Agricultural Development Allowance.

(iv) Amortisation of Preliminary Expenses.

15. Write notes on the following deductions:

(i) Insurance Premium.

(ii) Bonus.

(iii) Interest on Borrowings.

(iv) Contributions to Provident Fund, etc.

(v) Animals.

(vi) Bad Debts.

16. What are the expenses which are not allowed to be deducted while computing the income under the head 'Profits and Gains of Business or Profession'?
17. Write short notes on:
   (i) Telecom License fees.
   (ii) Expenditure on maintenance of ‘Guest Houses’ and ‘Holiday Homes’.
   (iii) Interest payable outside India.

18. Write short notes on:
   (i) Payment by AOPs/BOIs.
   (ii) Payments to Provident Funds, etc.
   (iii) Managerial remuneration.

19. What do you understand by the term ‘Capital Gains’? Illustrate.


21. Explain the Capital gains which are exempt from income-tax.

22. What are Short-term and Long-term Assets? Give two examples of each.

23. How are the Capital Gains computed? Illustrate.

24. (a) What do you understand by ‘full value of consideration’?
    (b) Write short notes on:
        (i) Cost of improvement.
        (ii) Indexed cost of acquisition.

25. What are the tax concessions in respect of Capital Gains?

26. What are the incomes chargeable under the head ‘Income from other sources’?

27. What deductions are allowed under the head ‘Income from other sources’?

28. What expenses are not allowed to be deducted under the head ‘Income from other sources’?
STUDY VI

AGGREGATION OF INCOME, SET-OFF OR CARRY FORWARD OF LOSSES AND DEDUCTIONS FROM TOTAL INCOME

This chapter deals with aggregation of income between family members of the assessee, set-off or carry forwarded of losses and deductions from total income as under Sections 80 to 80U. The Chapter emphasizes on tax incidence and tax implication of income of family members in relation to income of the assessee. Also in case of carry forward/set-off losses to subsequent period under various heads is also discussed elaborately. Moreover the deductions under Chapter VI of the Income Tax Act is also discussed in detail.

LEARNING OBJECTIVES

This chapter covers the following topics/concepts and the chapter is divided into four parts:

PART-I

- Aggregation of Income
- Transfer of Income (Section 60)
- Revocable Transfer of Assets (Section 61)
- Transfer irrevocable for a specified period (Section 62)
- Income of Spouse
- Income to son’s wife [Section 64(1)(vi)]
- Transfer to immediate or deferred benefit of Son’s Wife [Section 64(1)(vii)]
- Income to Spouse through a Third Person [Section 64(1)(vii)]
- Clubbing of income of minor child [Section 64(1A)]
- Income from the converted property [Section 64(2)]
- Recovery of Tax
- Certain Amounts Deemed as Income
  - Cash Credits (Section 68)
  - Unexplained Investment (Section 69)
  - Unexplained Money etc. (Section 69A)
  - Under Valued Investments or Valuables (Section 69B)
- Unexplained Expenditure (Section 69C)
- Amount borrowed or repaid on Hundi (Section 69D)

**PART-II**

- Set-off and Carry-forward of Losses
- Set-off of losses from one source against income from another source under the same head of income [Section 70]
- Carry forward and set-off of losses
- Carry forward and set-off of accumulated business loss and unabsorbed depreciation in certain cases of amalgamation or demerger etc. (Section 72A)
- Carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation of banking company in certain cases (Section 72AA)
- Treatment of carry-forward of losses of certain assessees

**PART-III**

- Deductions from Total Income, Rebates and Relief’s [Sections 80C to 80U (Chapter VIA)]
- Deduction on life insurance premia, contribution to provident fund, etc. (Section 80C)
- Deduction for contribution to pension fund (Section 80CCC)
- Deduction in respect of contribution to pension scheme of Central Government [Section 80CCD]
- Limit on deductions under Sections 80C, 80CCC and 80CCD (Section 80CCE)
- *Deduction in respect of subscription to long term infrastructure bonds (section 80CCF)*
- Deduction in respect of medical insurance premia (Section 80D)
- Deduction in respect of maintenance including medical treatment of a dependant who is a person with disability [Section 80DD]
- Deduction in respect of medical treatment, etc. (Section 80DDB read with Rule 11DD)
- Deduction in respect of repayment of loan taken for higher education (Section 80E)
- Deduction in respect of donations to certain funds, charitable institutions, etc. (Section 80G)
- Deduction in respect of rent paid (Section 80GG)
- Deduction in respect of certain donations for scientific research or rural development (Section 80GGA)
- Deduction in respect of contributions given by companies to political parties (Section 80GGB)
- Deduction in respect of contributions given by any person to political parties (Section 80GGC)
- Deduction in respect of profits and gains from projects outside India (Section 80HHB)
<table>
<thead>
<tr>
<th>Deduction in respect of profits and gains from housing projects in certain cases (Section 80HHA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits from Exports (Section 80HHC)</td>
</tr>
<tr>
<td>Deduction in respect of earnings in convertible foreign exchange (Section 80HHD)</td>
</tr>
<tr>
<td>Deduction in respect of profits from export of computer software, etc. (Section 80HHE)</td>
</tr>
<tr>
<td>Deduction in respect of profits and gains from export or transfer of film software, etc. (Section 80HHF)</td>
</tr>
<tr>
<td>Deduction in respect of profits and gains from industrial undertakings or enterprise engaged in infrastructure development (Section 80-IA)</td>
</tr>
<tr>
<td>Deduction in respect of profit and gains by an undertaking a enterprise engaged in development of Special Economic Zone [Section 80-IAB]</td>
</tr>
<tr>
<td>Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings [Section 80-IB]</td>
</tr>
<tr>
<td>Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC]</td>
</tr>
<tr>
<td>Deduction in respect of profits and gains from the business of collecting and processing bio-degradable waste (Section 80-JJA)</td>
</tr>
<tr>
<td>Deduction in respect of employment of new workmen (Section 80-JAA)</td>
</tr>
<tr>
<td>Deduction in respect of certain items of income by way of dividends, interest on securities, etc. (Section 80L)</td>
</tr>
<tr>
<td>Deduction in respect of certain incomes of Offshore Banking Units (Section 80LA)</td>
</tr>
<tr>
<td>Deduction in respect of royalties etc., from certain foreign enterprise (Section 80-O)</td>
</tr>
<tr>
<td>Deduction in respect of income of co-operative societies (Section 80P)</td>
</tr>
<tr>
<td>Deduction in respect of royalty income, etc., of authors of certain books other than text books (Section 80QOB)</td>
</tr>
<tr>
<td>Deduction in respect of remuneration from certain foreign sources in the case of Professors, Teachers etc. (Section 80R)</td>
</tr>
<tr>
<td>Deduction in respect of professional income from certain foreign sources (Section 80RR)</td>
</tr>
<tr>
<td>Deduction in respect of remuneration received for services rendered outside India from foreign employer (Section 80RRA)</td>
</tr>
<tr>
<td>Deduction in respect of royalty on patents (Section 80RRB)</td>
</tr>
<tr>
<td>Deduction in case of a person with disability (Section 80U)</td>
</tr>
<tr>
<td>Relief and Rebate in respect of Income-tax and Rates of Income-tax</td>
</tr>
<tr>
<td>Share of member of an association of persons or body of individuals in the income of the association or body (Section 86)</td>
</tr>
<tr>
<td>Income from an association of persons or a body of individuals (Section 86)</td>
</tr>
<tr>
<td>Relief when salary is paid in arrears or in advance [Section 89]</td>
</tr>
<tr>
<td>Relief under section 89:</td>
</tr>
</tbody>
</table>
6.1 AGGREGATION OF INCOME

In addition to the general provisions which are applicable to the assessment of tax-payers and the computation of their total income, there are special provisions in the Income-tax Act which lay down the method of computing the total income of an individual for income-tax purposes. In particular, Sections 60 to 65 of the Income-tax Act provide that in computing the total income of an individual for purposes of assessment, there shall be included all the items of income specified in these sections. The special provisions contained in these sections are designed to counteract the various attempts which an individual may make for avoiding or reducing his liability to tax by transferring his assets or income to other person(s) while, at the same time, retaining certain powers or interest over the property or its income. These provisions are explained below.

6.2 TRANSFER OF INCOME (SECTION 60)

Where a person transfers to any other person income (whether revocable or not) from an asset without transferring that asset, the income shall be included in the total income of the transferor. “Transfer” includes any settlement, trust, covenant, agreement or arrangement. The transfer also includes a lease for inadequate consideration and the income derived by the lessee from the leased property is included in the income of the lessor.

If the transferor transfers the asset and keeps the income for himself, the income shall be included in the income of transferor.

Section 60 has no application where assets producing income are transferred along with the income. C.I.T. v. Ram Prasad Mehta (1975) 100 ITR 468 (Bombay). There may be a field of operation of Sections 61 to 64 but certainly not of Section 60.

6.3 REVOCABLE TRANSFER OF ASSETS (SECTION 61)

Where a person transfers any asset to any other person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

The income under revocable transfer of asset shall be included in the income of transferor even when only a part of income from transferred asset has been applied for the transferor.

For this purpose assets include movable or immovable property whether situated in India or abroad.

As per Section 63, a transfer shall be deemed to be revocable if:

(i) it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor; or

(ii) it, in any way, gives the transferor a right to re-assume power directly, or indirectly over the whole or any part of the income or assets.
Examples of revocable transfers:
Some of the examples of revocable transfers are as follows:

(i) If there is an express clause of revocation in the instrument of transfer; or
(ii) If there is a sale with a condition of re-purchase; or
(iii) If the transfer is to a trust and if the transfer can be revoked with the consent of two or more beneficiaries; or
(iv) If the trustees are empowered in sole discretion to revoke the transfer; or
(v) If the transferor has power to change beneficiary or trustees.

However, re-transfer to the transferor must be in the same capacity in which he made the transfer or settlement. If a settlement is made by a Hindu undivided family and there is a re-transfer to one member of the family in his capacity as an individual and not in his capacity as a member of the family this cannot be termed a re-transfer for the purpose.

6.4 TRANSFER IRREVOCABLE FOR A SPECIFIED PERIOD (SECTION 62)

This is an exception to the general rule that in case of revocable transfer of an asset, the income from such an asset is to be included in the total income of transferor. If there is an irrevocable transfer of assets for a specified period, the income from such assets shall not be included in the income of transferor provided the following conditions are fulfilled:

(a) (i) The transfer was made before 1st April, 1961 and was not revocable for a period exceeding six years; or
(ii) The transfer is made through a trust and is not revocable during the life-time of the beneficiary; or
(iii) The transfer is not revocable during the life-time of the transferee;

Note, that the exemption ceases as soon as the period for which the asset was transferred expires or the beneficiary or the transferee, as the case may be, die.

(b) The transferor does not derive any direct or indirect benefit from such assets or income. If the payment reaches back to the transferor through a third party, who receives share from the income or, the settler is fully empowered to take a decision about the investment and can lend to himself without security, it amounts to getting indirect benefit from the income of the trust.

(c) The transfer is not to or for the benefit of the spouse or minor child (excluding minor married daughter) of the transfer.

Test Your Knowledge:
Under which of the following circumstances transfers of income is revocable?

(a) If there is a sale with a condition of re-purchase
(b) If the transferor has no power to change beneficiary or trustees.
(c) Both (a) and (b)
(d) Neither (a) nor (b)

Correct answer: (a)
6.5 INCOME OF SPOUSE

The following incomes of husband and wife are clubbed:

(a) Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)]

All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or kind from a concern in which such individual has a substantial interest, shall be included in the income of the individual. However, where the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his/her technical or professional knowledge and experience, the income shall not be included in the income of (other spouse) the assessee.

An individual shall be deemed to have a substantial interest in a concern -

(i) In a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives;

(ii) In any other case, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than 20% of the profits of such concern.

Where the individual is not entitled to receive any profit of the concern from which the spouse receives salary, commission, fees or other remuneration, such income shall not be included in the income of such individual and the spouse shall be assessable for this income.

Where both husband and wife have a substantial interest in the concern and both are in receipt of the remuneration in such concern, the remuneration from such concern is to be included in the total income of the husband or, as the case may be, the wife whose total income excluding the income referred to in that clause i.e. 64(1)(ii) is greater; (Circular No. 258, dated 14-6-79) and where any such income is once included in the total income of either spouse, any such income arising in any succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary so to do.

Illustration:

Mr. P is employed as Public Relation Officer in a company where Mrs. P holds 21 per cent equity shares. She has been holding the share before marriage with Mr. P., Mr. P gets a salary of ₹ 1,500 per month. The whole salary of ₹ 18,000 will be included in the income of Mrs. P provided Mr. P has no technical or professional qualification. It is immaterial that the remuneration so paid is genuine and not excessive and that Mrs. P had substantial interest in the company even before her marriage. Smt. Kamlabai Gujri v. C.I.T. (1986 157 ITR 33 (M.P.).

(b) Income to spouse from the assets transferred [Section 64(1)(iv)]

Where any individual transfers directly or indirectly any asset (other than a house
property) to the spouse, the income from such asset shall be included in the income of the transferor.

In order to attract the provisions of this section, it is not necessary that the asset must have been transferred by the assessee to his spouse in the same form in which it stands at the time the income arises. Conversion of assets from one form to another would be totally immaterial and it is also not essential that the transfer must have taken place directly between the spouses. However, there are exceptions to this rule:

(i) The transferor has received adequate consideration in money or money's worth. If the consideration was inadequate, proportionate income shall be included in the income of the transferor.

(ii) The transfer has been made in connection with an agreement to live apart. This separation can be either judicial or voluntary under circumstances in which a judicial separation can be granted.

(iii) The income from the assets transferred shall not be included in the income of transferor after the death of spouse, either transferor or transferee.

(iv) The income from assets transferred shall be included in the income of the transferor, only if the relationship as spouse exists on the two dates, i.e., the date of transfer and the date on which the income accrues or arises to the transferee. If any asset has been transferred before marriage, the income from such asset cannot be included in the income of the transferor.

(v) Only the direct income (including capital gains) earned with the help of the transferred assets shall be included in the income of the transferor. Any indirect income to the transferee from the transferred assets shall not be included in the income of the transferor.

Suppose, A transfers certain shares to his wife B. Dividends received on such shares are taxable to A. If B sells the shares and makes some capital gains, such gains are also taxable in A's hands. Now from the dividend money, B purchases some more shares and receives dividends on these new shares, such dividends are not taxable to A. In the same way, if B receives certain bonus shares on the shares transferred by her husband and later on she receives dividend on such bonus shares, the dividend shall not be included in the income of the transferor because the bonus shares were never transferred by her husband.

If some pin-money is given to wife by her husband neither the savings out of pin-money nor the income earned with the help of savings out of pin-money can be included in the income of husband.

6.6 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.

6.7 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.

**6.8 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

6.9 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 sub-section 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.

6.10 INCOME FROM THE CONVERTED PROPERTY [SECTION 64(2)]

Where an individual, being a member of Hindu Undivided Family, transfers his self-acquired property after 31st December, 1969 to the family for the common benefit of the family, or throwing it into the common stock of the family, or transfers it directly or indirectly to the family otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof, shall be included in the income of the transferor.

For this section “property” includes any interest in property, movable or immovable the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

Income from converted property to spouse after partition

Where the converted property has been the subject matter of total or partial partition amongst the members of the family, the income derived from such converted property as is received by the spouse of the transferor on partition shall be included in the income of the individual.

The income so included in the total income of the individual shall be excluded from the total income of the family or spouse, as the case may be.

The income from the above mentioned items shall first be computed under the appropriate heads in the hands of the transferee and after that it shall be included in the total income of the transferor under the head, “Income from other sources”. However, the income from house property transferred to spouse shall be computed under the head ‘Income from house property’ in the hands of transferor and not in the hands of the transferee.
An explanation was added by the Finance Act, 1979 w.e.f. 1.4.80 to provide that the term ‘income’ used in Section 64 includes ‘loss’. This amendment nullifies the decision in *Dayalbhai Madhavji Vadera v. C.I.T.* (1966) 60 ITR 551 of the Gujarat High Court that the term ‘income’ used in Sub-section (1) of Section 64 does not include a loss.

### 6.11 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.

### Test Your Knowledge

All income which arises to the minor child shall be clubbed in the income of his/her________.

(a) Parents  
(b) Siblings  
(c) Friends  
(d) Neighbors

Correct answer: (a)

### 6.12 CERTAIN AMOUNTS DEEMED AS INCOME

Under Sections 68, 69, 69A, 69B, 69C, 69D certain amounts are treated as the income of the assessee. Hence, while computing the total income of the assessee, such amounts shall be included in his income for income-tax purposes.

#### 6.12a Cash Credits (Section 68)

Where any sum is found credited in the books of an assessee maintained for any accounting year and the assessee is not in a position to offer explanation about the nature and source thereof or the explanation offered by him is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be treated as the income of the assessee in respect of the accounting year in which the cash credits are found to have made in the books.

This section comes into operation only when the following conditions are satisfied:

(i) The assessee maintains books of account;
(ii) A credit entry occurs in such books;
(iii) The assessee fails to explain the source and nature of the sum credited; or
(iv) The explanation offered by the assessee is not satisfactory, and the Assessing Officer comes to the conclusion that it is the undisclosed income of the assessee.

6.12b Unexplained Investment (Section 69)

Where the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income and the assessee is not in a position to offer any explanation about the nature and source of the investment or the explanation offered by him is inadequate or not satisfactory in the opinion of the Assessing Officer, the value of the investments may be treated as the income of the assessee for the financial year in which the investments are made.

6.12c Unexplained Money etc. (Section 69A)

Where the assessee is found to be the owner of any money, bullion, jewellery or any other valuable article and such article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee is not in a position to offer any explanation about the nature and source of acquisition of the articles or the explanation offered by him is not satisfactory in the opinion of the Assessing Officer, the value of such articles may be deemed to be the income of the assessee for the financial year in which he is found to be the owner thereof.

6.12d Under Valued Investments or Valuables (Section 69B)

This section empowers the Assessing Officer to charge tax on undisclosed incomes represented by undervaluation of assets. Where in any financial year, the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable articles and the Assessing Officer finds that the cost of these items shown by the assessee in the books of account is less than the value thereof and the assessee fails to explain the source of excess amount or the explanation offered by him is not satisfactory, the excess amount may be treated as the income of the assessee for the financial year in which he is found to have made the investment or is found to be in possession of the valuables.

6.12e Unexplained Expenditure (Section 69C)

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation offered by him is not satisfactory in the opinion of the Assessing Officer, the amount of such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year, i.e., the financial year in which he has incurred the expenditure.

A proviso has been inserted in Section 69C with effect from the assessment year 1999-2000, which provide that notwithstanding any thing contained in any other provisions of the Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.
6.12f Amount borrowed or repaid on Hundi (Section 69D)

Where any amount is borrowed on Hundi from, or any amount due thereon is repaid (including interest) to any person otherwise than through an ‘account payee’ cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid, as the case may be. However, when any borrowing on a hundi has been deemed as income of the borrower, such person shall not be liable to be assessed on repayment of such amount along with the amount of interest paid on the amount borrowed.

Test Your Knowledge

Which of the following amounts are treated as income of the assessee?

(a) Cash credits
(b) Amount given to a charitable trust
(c) Under-valued investments or valuables
(d) Amount borrowed or repaid on Hundi

Correct answer: (a), (c), (d)

PART-II

6.13 SET-OFF AND CARRY-FORWARD OF LOSSES

Income-tax is levied on the total income of the previous year of an assessee. Hence, it is necessary to ascertain the total income. Sometimes the assessee incurs a loss from a source of income and unless such loss is set-off against any income, the net result of the assessee’s activities during the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination. For this purpose, the Income-tax Act contains specific provisions (Sections 70 to 80) for the set-off and carry-forward of losses.

6.14 SET-OFF OF LOSSES FROM ONE SOURCE AGAINST INCOME FROM ANOTHER SOURCE UNDER THE SAME HEAD OF INCOME [SECTION 70]

If the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee is entitled to set off the amount of such loss against his income from any other source under the same head.

Exception to the General Rule: However, the following are the exceptions to general rule:

(i) Loss from Speculation Business: Income from speculation business is computed under the head income from business or profession. But if there is any loss from speculation business, it cannot be set-off against the income from other business or profession. It can be set-off only against the profit in a
speculation business. However, the loss of non-speculation business can be set-off against the income from speculation business.

(ii) **Loss from the activity of owning and maintaining race horses** — Loss incurred in the business of owning and maintaining race horses cannot be set off against any income except income from such business. However, loss from any activity other than the business of owning and maintaining race horses can be set off against income from the business of owning and maintaining race horses.

(iii) W.e.f. Assessment Year 2003-04 short term capital loss can be set off from any capital gain (long-term or short-term). But long-term capital loss can be set off only against long-term capital gain.

(A) **Loss from business or profession**

Any loss from business or profession (other than speculation business or loss from the activity of owning and maintaining race horses) can be set off against the income from any other business or profession including the income from speculation business or income from the activity of owning and maintaining race horses.

If any business has been discontinued during the year, the loss from such business can also be set-off from the income of other business or profession.

The loss suffered by a wholly owned subsidiary company cannot be set-off by the parent company, since both are separate assesses. Similarly, where loss incurred by a wholly owned subsidiary company is reimbursed by the holding company, the subsidiary company does not use the right to carry forward and set-off the loss. [C.I.T. v. Handicraft Handloom Export Corporation (1982) 133 ITR 590 (Delhi)].

(B) **Loss from speculation business**

Such loss can be set-off only against the income from speculation business. It is not essential that the nature of the other speculation transaction must be the same. Speculative transactions in different commodities and in different markets are to be treated as one business. However, a loss from an illegal speculation business cannot be set-off against income from any lawful speculation. [C.I.T. v. K.J. Kotecha 107 ITR 101 (SC)]. Similarly, where the assessee earns commission on speculative transactions, he is not entitled to set-off speculative loss against such commission because there is no element of speculation in the commission [C.I.T. v. Pangal Vittal Nayak & Co. Pvt. Ltd. (1969) 74 I.T.R. 754 (S.C.)]. By virtue of an explanation to Section 73 where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads: “Interest on securities”, “Income from House Property”, “Capital gains”, “Income from other sources”, or a company the principal business of which is the business of banking or granting of loans and advances) consists of the purchase and sale of shares of other companies, such company shall for the purpose of this section (Section 73), be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

(C) **Set-off of loss from one head against income from another head [Section 71]**

The provision of Section 71 reads as under:

(a) an assessee not having any income under the head “Capital gains” and having loss from income under other heads (excluding capital gains) can set
off such loss against his income under any other head (other than “capital gains”);
(b) loss under any head of income (other than “capital gains”) can be set off against income from any head of income, including “capital gains”;
(c) loss under the head “capital gains” cannot be set off against income under any other head. It must be set off only against income from “capital gains”.

(D) Set-off of losses under the head ‘income from house property’

Where the assessee incurs any loss under the head income from house property it can be set off against the assessee’s any other income under other head during the previous years where such loss is not fully adjusted under other heads of income in the same assessment year, then the balance loss shall be allowed to be carried forward and set off in subsequent years subject to a limit of eight assessment years against income from house property.

(E) Loss from a source which is exempt

Loss incurred by an assessee from a source, income from which is exempt, cannot be set-off against income from a taxable source.

**Test Your Knowledge**

Short term capital loss can be set-off from

(a) Short-term capital gain
(b) Long-term capital gain
(c) Both (a) and (b)
(d) Neither (a) nor (b)

Correct answer: (c)

6.15 CARRY-FORWARD AND SET-OFF OF LOSSES

If it is not possible to set-off the losses during the same assessment year in which these occurred, so much of the loss as has not been so set-off out of the following losses, can be carried forward to the following assessment year and so on to be set-off against the income of those years provided the losses have been determined in pursuance of a return filed by the assessee and it is the same assessee who sustained the loss.

(i) Loss in non-speculation business or profession.
(ii) Loss in speculation business.
(iii) Loss in transfer of capital assets [whether short-term or long-term].
(iv) Loss from activity of owning and maintaining of race horses.
(v) Loss under the head ‘Income from House Property’ so far as it relates to interest on borrowed capital referred to in Section 24(1)(vi). It is applicable up to assessment year 1996-97 only.
However, losses suffered under the following heads are not allowed to be carried forward and set off:

1. Losses under the head ‘salaries’.
2. Losses under the head ‘Income from other sources’ (excepting loss suffered from the activity of owning and maintaining race horses).

(A) Loss in non-speculation business

It shall be set-off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year.

From this it follows that the loss from non-speculation business or profession can be set-off against the income of the business in which it was suffered or any other business or profession either old or new including speculation business income or from any other head, such as house property, or other sources, if the income under this head forms part of the trading activities of the assessee. [Western States Trading Co. (P) Ltd. v. C.I.T. (1971) 80 ITR 21 (SC)].

The loss can be set-off against the business profits of the year provided such profits are assessable to tax. If the profits are exempt from tax for any reason, no set-off can be made by the income-tax officer against such profits.

Conditions for carry forward and set-off of business loss

(i) The right of carry-forward and set-off is available to the same assessee who has sustained the loss. A holding company however, cannot claim to carry forward the losses, if any, incurred by its wholly owned subsidiary company. Exceptions to this rule are (a) cases of succession by inheritance [a loss incurred by the father in the course of carrying on his business can be carried forward and set-off by his son, if the son succeeds to the business of his father on account of the father's death but not otherwise] (b) accumulated business loss of an amalgamating company under Section 72A (c) the share of loss of partnership taken over by one of its partners can also be set-off by the partner [Dwarkadass Leeladhar v. CIT (1963) 47 ITR 619 (Ker.)]

However, loss incurred by HUF cannot be carried forward and set-off after its partition against income of firm formed thereafter by certain coparceners (Keshrichand Bhanabhai v. CIT (1951) 20 ITR 201 (Bombay)).

(ii) The loss can be carried forward to a maximum of eight consecutive assessment years immediately succeeding the assessment year for which the loss was first computed.

In case of a business on which rehabilitation allowance has been allowed, the previous losses are allowed to be carried forward to the assessment year relevant to the previous year in which the business was so revived or re-established and are allowed to be set-off against the profits of that assessment year. Any balance of loss can be carried forward to the succeeding seven assessment years.

(iv) Where any unabsorbed depreciation or capital expenditure on scientific
research has been brought forward along with business loss, the business loss shall first be set-off.

**In case where profits are insufficient to absorb brought forward losses, current depreciation and current business losses, the same should be deducted in the following order:**

(a) *Current scientific research expenditure* [under Section 35(1)].
(b) *Current Depreciation* [under Section 32(1)].
(c) *Brought forward business losses* [under Section 72(1)].
(d) *Unabsorbed family planning promotion capital expenditure* [under Section 36(1)(ix)].
(e) *Unabsorbed Depreciation* [under Section 32(2)].
(f) *Unabsorbed scientific research expenditure* [under Section 35(4)].

### 6.16 Carry forward and set-off of accumulated business loss and unabsorbed depreciation in certain cases of amalgamation or demerger etc. (Section 72A)

W.e.f. assessment year 2000-2001, Section 72A has been substituted by new section to provide for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in case of:

(i) amalgamation [Section 72A(1), (2) and (3)], or
(ii) demerger [Section 72A(4) and (5)], or
(iii) reorganisation of business [Section 72A(6)].

**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 (xiiiib) 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(xiiiib) 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 (xiiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

**Note:** “Accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

“Unabsorbed depreciation” means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the
amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

**(B) Loss in speculation business [Section 73]**

Where, for any assessment year, any loss computed in respect of a speculation business has not been wholly set-off against the profits of another speculation business, it shall be carried forward to the following assessment year and shall be set-off against the profits of any speculation business carried on by him and assessable for the assessment year.

In case of speculation loss even if the particular speculation business in which there is loss is discontinued, this loss can be carried forward to be set-off in the succeeding year against the profits of any other speculation business.

This loss can be carried forward to a maximum of four consecutive assessment years immediately succeeding the assessment year for which the loss was first computed.

However, the loss from an illegal speculation business or loss incurred in speculation business in banned items can be neither set-off against income from any lawful speculation business nor can it be carried forward for being set-off in the subsequent year against income even from an illegal speculation business because the law assumes that any illegal business dies with all its losses in the same year *[CIT v. Kunji 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. \cite{C.I.T. v. Madhukant M. Mehta (1981) 132 ITR 159 (Guj.).}

\textbf{(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

   \begin{itemize}
   \item[(i)] it shall be set off against the profits and gains of any specified business carried on by him and
   \item[(ii)] if the loss can not be wholly set off, the amount of loss not set off shall be carried forward to the following assessment year and so on..
   \end{itemize}

\textbf{(D) Set-off and carry forward of capital losses [Section 74]}  

(i) Where, in respect of any assessment year, the net result of the computation under the head “Capital gains” is a loss to the assessee, it can be carried forward to the following assessment year. The short-term and long-term losses shall be separately carried forward. In case of short-term capital loss it can be set off against income, if any, under the head “Capital gains” (whether short-term or long-term) assessable for that assessment year in respect of any other capital asset. But in case of long-term capital loss, it can be set off only against long-term capital gain.

(ii) While losses on transfer of capital assets, whether short-term or long-term cannot be set off against any other income of the assessee under other heads of income i.e. heads other than ‘capital gains’ in the previous year in which such loss was incurred, it can be carried forward to be set off against capital gains if any during the next eight assessment years.

\textbf{(E) Loss on maintenance of race horses}

Where an assessee who is the owner of race horses sustains a loss in the activity of owning and maintaining race horses, he can carry-forward and set-off such loss against his income (Prize money received on a race horse or race horses) from the activity of owning and maintaining race horses in subsequent years. This loss can be carried forward to a maximum of four assessment years immediately succeeding the assessment year for which the loss was first computed.

\textbf{(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.
6.17 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.

6.18 TREATMENT OF CARRY-FORWARD OF LOSSES OF CERTAIN ASSESSEES

(1) Carry-forward and set-off of losses in case of change in constitution of firm (Section 78)

Where a change has occurred in the constitution of a firm, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.
(2) Carry-forward and set-off of losses in case of succession of business or profession

When a business or profession is succeeded by another person, the brought forward losses by the predecessor can be set-off against the income earned by the predecessor before the succession. The successor is not entitled to carry forward the losses sustained by the predecessor and set them off against the income earned by him. However, there is exception. If the succession is by inheritance, the heir-at-law is entitled to carry-forward and set-off the losses sustained by the predecessor provided the business in question continues to be carried on by the successor.

(3) Carry-forward and set-off of losses of companies in which the public are not substantially interested (Section 79)

The losses of companies in which the public are not substantially interested can be carried forward and set-off only if the following condition is satisfied:

(a) The shares of the company carrying not less than 51 per cent of the voting power were beneficially held by the same persons on the last day of the year or years in which the loss was incurred and also on the last day of the previous year in which the brought forward loss is to be adjusted. Where a change in voting power of more than 51 per cent of share holding has occurred between the two dates mentioned above (i.e. last day of the year of occurrence of loss and the last day of the previous year in which the brought forward loss is to be adjusted), the assessee will not be entitled to the benefit of set-off.

However, the benefit of set-off will not be denied if the change in voting power is due to the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift.

The effect of this provision is that if the majority of the voting power is not in the same hands both on the last day of the previous year in which the loss was sustained by the closely-held company and on the last day of the previous year in which the set off is claimed, set off will not be allowed under Section 72. This is obviously to frustrate attempts at trafficking in losses.

It has been further provided by Finance Act, 1999 w.e.f. 1.4.2000 that benefit of set off will also not be denied in the case where any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty one per cent shareholders of the amalgamating or demerged foreign company continue.

Test Your Knowledge

In which case the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his/her share of profits, if any, in the firm in respect of the previous year?

(a) When a change occurred in constitution of firm
(b) When a business or profession is succeeded by another person
(c) When the public are not substantially interested in companies
(d) None of the above

Correct answer: (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.

PART-III

The scheme of the Income-tax Act is to provide for various tax exemptions and concessions in three forms, namely —

(i) Incomes which are wholly exempt from tax by virtue of their exclusion from the scope of total income under Sections 10 to 13A;

(ii) Incomes which are includible in the total income for rate purposes but are entitled for rebate under Section 86; and

(iii) Deductions from gross total income which are allowed for the purposes of computing total income in respect of payments, investment and in respect of certain income.

At the outset, it must be noted that the deductions from gross total income are available only to the assessees where the gross total income is a positive figure. If however, the gross total income is nil or is a loss, the question of any deduction from the gross total income does not arise. For this purpose, the expression ‘gross total income’ means the total income of the assessee computed in accordance with the provisions of the Income-tax Act before making any deduction under Chapter VIA. The aggregate of income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as “Gross Total Income”. Sections 80A to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessees from their gross total income. However, the aggregate amount of the deductions shall not exceed the gross total income of the assessee.

These deductions are allowed from gross total income after reducing the following incomes from gross total income:

- Long-term Capital Gains
- Short-term Capital Gains under Section 111A
- Lotteries
- Income under Sections 115A, 115AB, 115AC, 115ACA, 115AD, 115BBA, 115D

6.19 DEDUCTION ON LIFE INSURANCE PREMIA, CONTRIBUTION TO PROVIDENT FUND, ETC. (SECTION 80C)

Eligibility: (a) an individual; (b) a Hindu undivided family.

Entitlement: Deduction from the Gross Total Income of an amount equal to the investments made, subject to a maximum amount of ₹ One lakh; exemption is allowed if the amount contributed or ₹ 1 lakh, whichever is lower.
**Nature of Investments:**

(a) Life Insurance policy taken on the life of an individual assessee or spouse and any child of such individual, and any member of the Hindu Undivided Family. But deduction is not allowed where the premium paid on Life Insurance Policy exceeds 20% of the capital sum assured.

(b) Amounts paid to effect or to keep in force a contract for a non-commulative deferred annuity not being an annuity plan referred to in clause (j) below on the life of: (i) in the case of an individual, the individual, spouse or any child of such individual and

However, such contract should not contain a provision for exercise of an option by the insured to receive cash payment in lieu of the payment of the annuity.

(c) Deduction from the salary payable by or on behalf of the Government to any individual, in accordance with the conditions of his service, for securing to him a deferred annuity or making provision for his wife or children, to the extent of one-fifth of salary.

(d) Any contribution made by an individual only to any provident fund to which the Provident Funds Act, 1925, applies; a Recognised provident fund; an approved superannuation fund.

(e) Any contribution to (i) any provident fund set-up and notified by the Central Government in the Official Gazette, [public provident fund has been notified for this purpose] or (ii) a ten-year account or a fifteen-year account under the Post Office Savings Bank (Cumulative Time Deposits) Rules, 1959, as amended from time to time, where such sums are deposited/contributions are made to an account standing in the name of: in the case of an individual, the individual himself or a minor of whom he is the guardian; any member of the Hindu Undivided Family in the case of a HUF and in the case of an association of persons or body or individuals, such association or body.

(f) Subscription to the notified securities of the Central Government.

(g) Any contribution to a PPF by individual or HUF.

(h) Subscription to other notified savings certificates defined in Section 2(c) of the Government Savings Certificates Act, 1959 [For this clause, National Savings Certificates (VIII) issue has been notified] and interest accured deemed to be reinvested also qualifies.

(i) Contributions made by an individual or HUF, for participation in the Unit-Linked Insurance Plan, 1971, deemed to have been made under Section 19(8)(a) of the Unit Trust of India Act, 1963. [For this clause, Dhanaraksha-1989 plan of LIC Mutual Fund has been notified].

(j) Contributions made in the name of an individual or HUF for participation in any notified Unit-Linked Insurance Plan of the LIC Mutual Fund.

(k) Any contribution to effect or keep in force any notified annuity plan of the LIC or any other insurer.

(l) Any subscription, to any units of any Mutual Fund or the Unit Trust of India
under any notified plan formulated by the Central Government.

(m) Any contribution to any pension fund set up by any Mutual Fund as notified by the Central Government.

(n) Subscription to the notified deposit scheme of or contribution to any such pension fund set up by the National Housing Bank established under Section 3 of the National Housing Bank Act, 1987. [For this clause, Home Loan Account Scheme of National Housing Bank has been notified].

As inserted by Finance (No. 2) Act, 1991 w.e.f. assessment year 1992-93 any such deposit scheme as notified by the Central Government and floated by:

(a) a public sector company which is engaged in providing long term finance for construction or purchase of houses in India for residential purposes, or

(b) any authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both;

(o) Only tuition fees (excluding any payment towards any development fees or donation or payment of similar nature), whether at the time of admission or thereafter,—

to any university, college, school or other educational institution situated within India;

(p) For purchase or construction of a residential house property, the income of which is chargeable to tax under the head “Income from House Property”, where such payments are made towards or by way of:

(i) any instalment or part payment of the amount due under any self-financing or other scheme of any development authority, housing board or other authority engaged in the construction and sale of house property on ownership basis; or

(ii) any instalment or part payment of the amount due to any company or co-operative society of which the assessee is a shareholder or member towards the cost of the house property allotted to him; or

(iii) re-payment of the amount borrowed by the assessee from: (1) the Central Government or any State Government; or (2) any bank, including a co-operative bank, or (3) the Life Insurance Corporation, or (4) the National Housing Bank, or (5) any public company formed and registered repayment of principal part only not interest in India with the main object of carrying on the business of providing long-term finance for the construction or purchase of houses in India for residential purposes, eligible for deduction under Section 36(1)(viii), or (6) any company in which the public are substantially interested or any co-operative society, where such company or co-operative society is engaged in the business of financing the construction of houses; or (7) the assessee’s employer where such employer is a public company or a public sector company or a university established by law or a college affiliated to such university or a local authority or a cooperative society;
(8) the assessee’s employer where such employer is an authority or a board or a corporation or any other body established under a Central or State Act (w.e.f. A.Y. 2006-07).

(iv) stamp duty, registration fee and other expenses for the purpose of transfer of such house property to the assessee.

However, no deduction is allowed in respect of any payment towards or by way of—

(A) the admission fee, cost of share and initial deposit which a shareholder of a company or a member of a cooperative society has to pay for becoming such shareholder or member; or

(B) the cost of any addition or alteration to, or renovation or repair of, the house property which is carried out after the issue of completion certificate in respect of the house property by the authority competent to issue such certificate or after the house property or any part thereof has either been occupied by the assessee or any other person on his behalf or has been let out; or

(C) any expenditure in respect of which deduction is allowable under the provisions of Section 24.

(q) Subscription to equity shares or debentures or units forming part of any eligible issue of capital i.e. issue made by a company registered in India or a public financial institution or an approved mutual fund for the purpose of developing, maintaining and operating an infrastructure facility as defined in the explanation to Sub-section (4) of Section 80-IA or for generation, or for generation and distribution of power or for providing telecommunication services whether basic or cellular.

(r) Fixed deposits for a minimum period of 5 years in any Scheduled Banks (w.e.f. A.Y. 2007-08).

(s) As subscription to such bonds issued by the National Bank for Agriculture and Rural Development, as the Central Government may, by notification in the Official Gazette specify in this behalf.

(t) In an account under the Senior Citizens Savings Scheme Rules, 2004.

(u) As five year time deposit in an account under the Post Office Time Deposit Rules, 1981.

In case of any single premium policy, if such policy is surrendered within two years of the date of commencement of insurance, the amount of deduction of income-tax allowed earlier shall be deemed to be the tax payable in the year of surrender.

**Consequences of default/failure to pay premium**:

Where, in any previous year, an assessee —

(i) terminates his contract of insurance under the Life Insurance Policy, either by notice to that effect or, where the contract ceases to be in force by reason of failure to pay any premium, by not reviving the contract of insurance, before premiums have been paid for two years; or
(ii) terminates his participation in any unit-linked insurance plan of U.T.I. or L.I.C. Mutual fund, by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years; or

(iii) transfers the house property referred to at Sl. No. ‘l’ as aforesaid, before the expiry of five years from the end of the financial year in which possession of such property is obtained by him, or received back, whether by way of refund or otherwise, any amount specified therein, then —

(i) no deduction shall be allowed with reference to any of the sums eligible for deduction and

(ii) the deductions of income-tax allowed in respect of the previous year or years preceding such previous year, shall be deemed to be tax payable by the assessee in the assessment year relevant to such previous year and shall be added to the tax on the total income of the assessee with which he is chargeable for such assessment year.

(iv) if any shares or debentures or units emanating out of an eligible issue of capital to promote infrastructure is transferred within three years of their acquisition the tax rebate allowed on this account shall be deemed to be the tax liability of the pervious year in which such premature transfer took place.

Sub-section (3) provides that the provisions of Sub-section (2) shall apply only to so much of any premium or other payment made on an insurance policy other than a contract for a deferred annuity as is not in excess of twenty per cent of the actual capital sum assured.

Explanation.—In calculating any such actual capital sum, no account shall be taken—

(i) of the value of any premiums agreed to be returned, or

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

6.20 DEDUCTION FOR CONTRIBUTION TO PENSION FUND (SECTION 80CCC)

An individual who deposits out of his taxable income to any pension fund of the Life Insurance Corporation of India or any insurer, shall get a deduction from his gross total income of the amount so deposited not exceeding ₹ 1,00,000.

6.21 DEDUCTION IN RESPECT OF CONTRIBUTION TO PENSION SCHEME OF CENTRAL GOVERNMENT [SECTION 80CCD]

A new pension scheme has been introduced by Finance (No. 2) Act, 2004 which is applicable to new employees of the Central Government employed on or after 01.01.2004 or any other individual assessee(w.r.e.f 1st april 2009). According to this section, it is mandatory for such employee to contribute 10% of salary every month towards the pension account. A matching contribution is required to be made by the Central Government in this account.
Thus, Section 80CCD makes provision for deduction in respect of contribution to pension scheme of Central Government. Deduction is allowed upto 10% of salary for own contribution and upto 10% of salary for contribution made by the Central Government. Pension/amount received from pension fund, shall be taxable as income in the year in which such amount is received by the assessee or his nominee.

Whereunder the deduction is claimed under this section, no rebate shall be granted in respect of such contribution under Section 88 for any assessment year ending before April 1, 2006. Also, no deduction with reference to such amount shall be allowed under Section 80 for any assessment year beginning on or after April 1, 2006. Salary includes dearness allowance, if terms of employment so provide, but excludes all other allowances and perquisites.

The assessee shall be deemed not to have received any amount in the previous year if such amount is used for purchasing an annuity plan in the same previous year.

**Test Your Knowledge**

Deduction is not allowed where the premium paid on Life Insurance Policy exceeds ______ of the capital sum assured.

(a) 10%
(b) 20%
(c) 25%
(d) 30%

Correct answer: b

6.22 LIMIT ON DEDUCTIONS UNDER SECTIONS 80C, 80CCC AND 80CCD (SECTION 80CCE)

The aggregate amount of deductions under Sections 80C, 80CCC and sub-section (1) of 80CCD shall not in any case, exceed one lakh rupees.

6.23 DEDUCTION IN RESPECT OF SUBSCRIPTION TO LONG TERM INFRASTRUCTURE BONDS (SECTION 80CCF):

In computing the total income of an assessee, being an individual or a Hindu undivided family, there shall be allowed a deduction of a sum which shall not exceed twenty thousand rupees, paid or deposited, during the previous year relevant to the A.Y 2012-13, as subscription to long-term infrastructure bonds, notified by the Central Government.

6.24 DEDUCTION IN RESPECT OF MEDICAL INSURANCE PREMIA (SECTION 80D)

(1) In computing the total income of an assessee, being an individual or a Hindu undivided family, there shall be deducted such sum, as specified in sub-section (2) or sub-section (3), payment of which is made by any mode, other than cash, in the previous year out of his income chargeable to tax.

(2) Where the assessee is an individual, the sum referred to in sub-section (1) shall be the aggregate of the following:
(a) the whole of the amount paid to effect or to keep in force an insurance on the health of the assessee or his family or “any contribution made to the Central Government Health Scheme” and the sum does not exceed in the aggregate ₹15000; and

(b) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee as does not exceed in the aggregate ₹15,000.

Explanation: family means the spouse and dependant children of the assessee.

(3) Where the assessee is a Hindu undivided family, the sum referred to in sub-section (1) shall be the whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided family as does not exceed in the aggregate ₹15,000.

(4) In case of a senior citizen the amount shall not exceed ₹20,000.

Explanation. For the purposes of this sub section, senior citizen means an individual resident in India who is of the age of sixty five years or more at any time during the relevant previous year.

6.25 DEDUCTION IN RESPECT OF MAINTENANCE INCLUDING MEDICAL TREATMENT OF A DEPENDANT WHO IS A PERSON WITH DISABILITY [SECTION 80DD]

(1) Where an assessee, being an individual or a Hindu undivided family, who is a resident in India, has, during the previous year,—

(a) incurred any expenditure for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability; or

(b) paid or deposited any amount under a scheme framed in this behalf by the Life Insurance Corporation or any other insurer or the Administrator or the specified company subject to the conditions specified in Sub-section (2) and approved by the Board in this behalf for the maintenance of a dependant, being a person with disability,

the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of a sum of rupees seventy five thousand rupees from his gross total income in respect of the previous year:

Provided that where such dependant is a person with severe disability, the provisions of this sub-section shall have effect as if for the words “seventy-five thousand rupees”, the words “one hundred thousand rupees” had been substituted.

(2) The deduction under clause (b) of Sub-section (1) shall be allowed only if the following conditions are fulfilled, namely:—

(a) the scheme referred to in clause (b) of Sub-section (1) provides for payment of annuity or lump sum amount for the benefit of a dependant, being a person with disability, in the event of the death of the individual or the member of the Hindu undivided family in whose name subscription to the scheme has been
made;

(b) the assessee nominates either the dependant, being a person with disability, or any other person or a trust to receive the payment on his behalf, for the benefit of the dependant, being a person with disability.

(3) If the dependant, being a person with disability, predeceases the individual or the member of the Hindu undivided family referred to in Sub-section (2), an amount equal to the amount paid or deposited under Clause (b) of Sub-section (1) shall be deemed to be the income of the assessee of the previous year in which such amount is received by the assessee and shall accordingly be chargeable to tax as the income of that previous year.

(4) The assessee, claiming a deduction under this section, shall furnish a copy of the certificate issued by the medical authority in the prescribed form and manner, along with the return of income under Section 139, in respect of the assessment year for which the deduction is claimed:

Provided that where the condition of disability requires reassessment of its extent after a period stipulated in the aforesaid certificate, no deduction under this section shall be allowed for any assessment year relating to any previous year beginning after the expiry of the previous year during which the aforesaid certificate of disability had expired, unless a new certificate is obtained from the medical authority in the form and manner, as may be prescribed, and a copy thereof is furnished along with the return of income.

Explanation.—For the purposes of this section,—

(a) "Administrator" means the Administrator as referred to in clause (a) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);

(b) "dependant" means—

(i) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them;

(ii) in the case of a Hindu undivided family, a member of the Hindu undivided family, dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance, and who has not claimed any deduction under Section 80U in computing his total income for the assessment year relating to the previous year;

(c) "disability" shall have the meaning assigned to it in clause (i) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);

(d) "Life Insurance Corporation" shall have the same meaning as in Clause (iii) of Sub-section (8) of Section 88;

(e) "medical authority" means the medical authority as referred to in clause (p) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);

(f) "person with disability" means a person as referred to in Clause (f) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
(g) "**person with severe disability**" means a person with eighty per cent or more of one or more disabilities, as referred to in Sub-section (4) of Section 56 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);

(h) "**specified company**" means a company as referred to in Clause (h) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002).

### 6.26 DEDUCTION IN RESPECT OF MEDICAL TREATMENT, ETC.
(SECTION 80DDB READ WITH RULE 11DD)

Where an individual or HUF who is resident in India has, during the previous year, actually paid any amount for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board—

(a) for himself or a dependant, in case the assessee is an individual; or

(b) for any member of a Hindu undivided family, in case the assessee is a Hindu undivided family,

the assessee shall be allowed a deduction of the amount actually paid or a sum of forty thousand rupees, whichever is less, in respect of that previous year in which such amount was actually paid:

Provided that no such deduction shall be allowed unless the assessee furnishes with the return of income, a certificate in prescribed form (No. 10-I) from a neurologist, an oncologist, a urologist, a haematologist, an immunologist or such other specialist, as may be prescribed, working in a Government hospital:

Provided further that the deduction under this section shall be reduced by the amount received, if any, under an insurance from an insurer, or reimbursed by an employer, for the medical treatment of the person referred to in Clause (a) or Clause (b);

Provided also that where the amount actually paid is in respect of the assessee or his dependant or any member of a Hindu undivided family of the assessee and who is a senior citizen, the provisions of this section shall have effect as if for the words "forty thousand rupees", the words "sixty thousand rupees" had been substituted.

**Explanation.**—For the purposes of this section,—

(i) "**dependant**" means—

(a) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them,

(b) in the case of a Hindu undivided family, a member of the Hindu undivided family, dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance;

(ii) "**Government hospital**" includes a departmental dispensary whether full-time or part-time established and run by a Department of the Government for the medical attendance and treatment of a class or classes of Government servants and members of their families, a hospital maintained by a local authority and any other hospital with which arrangements have been made by the Government for the treatment of Government servants;
(iii) “insurer” shall have the meaning assigned to it in Clause (9) of Section 2 of the Insurance Act, 1938 (4 of 1938);

(iv) “senior citizen” means an individual resident in India who is of the age of sixty-five years or more at any time during the relevant previous year.

6.27 DEDUCTION IN RESPECT OF REPAYMENT OF LOAN TAKEN FOR HIGHER EDUCATION (SECTION 80E)

The deduction of an amount actually paid by an individual during the previous year out of his income chargeable to tax by way of an interest on loan, taken by him from any financial institution or any approved charitable institution for the purpose of pursuing his higher education. The deduction will be available in computing the total income in respect of initial assessment years and the seven assessment years immediately succeeding the initial assessment year or until the interest thereon is paid by such individual in full, whichever is earlier.

The upper limit of deduction is ₹ 40,000 including interest.

The expression “higher education” is being defined to mean any course of study pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority to do so. The expression “financial institution” is being defined to mean a banking company to which the “Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in Section 51 of the Act) or any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf. The expression “approved charitable institution” is being defined to mean an institution specified in, or as the case may be, an institution established for charitable purposes and notified by the Central Government under Section 10(23C) or an institution referred to in Section 80G(2)(a). The expression “initial assessment year” means the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan.

Test Your Knowledge

What is the upper limit of deduction (including interest) on loan, taken by an individual from any financial institution or any approved charitable institution for the purpose of pursuing his/her higher education?

- (a) ₹ 30,000
- (b) ₹ 40,000
- (c) ₹ 50,000
- (d) ₹ 60,000

Correct answer: (b)

6.28 DEDUCTION IN RESPECT OF DONATIONS TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC. (SECTION 80G)

Deduction under this section is allowed to all type of assesses. Further, Sub-
section (5A) of Section 80G clarifies that is a case where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not again qualify for deduction under any other provision of the Act for the same or any other assessment year:

**Quantum of deduction:**

**A) 100% Deduction without any qualifying limit:**

(i) National Defense fund.
(ii) Prime Minister's National relief fund.
(iii) Prime Minister's Earthquake relief fund.
(iv) Africa fund.
(v) National Trust for welfare of persons with autism, cerebral palsy, mental retardation and multiple disabilities.
(vi) National cultural fund set up by the Central Government.
(vii) The Chief Minister's relief fund or the lieutenant Governor's relief fund.
(viii) National Illness Assistance fund.
(ix) The Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996.
(x) The Army/Air force Central welfare fund or the Indian Naval Benevolent fund.
(xi) Any fund set up by a State Government to provide medical relief to poors.
(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.

**B) 50% Deduction without any qualifying limit:**

(i) Jawaharlal Nehru Memorial Fund.
(ii) Indira Gandhi Memorial Trust.
(iii) Rajiv Gandhi Foundation.
(iv) National Children's Fund.
(v) Prime Minister's Drought Relief Fund.

**C) 100% Deduction subject to qualifying limit:**

(i) Any sum to Government or any approved local authority, institution or association to be utilized for promoting family planning.
(ii) Any sum paid by the assessee, being a company, in the previous year as donation to Indian Olympic Association or to any other association established in India and notified by the Central Government for:
   I. Development of infrastructure for sports and games or
   II. Sponsorship of sports and games in India.

(D) 50% Deduction subject to qualifying limit:
(i) Donation to Government or any approved Local Authority, Institution or Association to be utilized for any Charitable purpose other than promoting family planning.
(ii) Any other Fund or Institution, which satisfies the conditions of Section 80G(5).
(iii) Notified Temple, Mosque, Gurudwara, Church or any other place notified by the Central Government to be of historic, as chorological or artistic importance, for renovation or repair of such place.
(iv) Any corporation established by the Central or State Government specified under Section 10(26BB) for promoting interests of the members of a minority community.
(v) Any authority constituted in India by or under any law for satisfying the need for housing accommodation or for the purpose of planning development or improvement of cities, towns and villages or for both for applying qualifying limit, all donations made to funds/institutions covered under (C) and (D) above shall be aggregated and the aggregate amount shall be limited to 10% of adjusted Gross Total Income:
   — Adjusted Gross total income means the “Gross Total Income” as reduced by:
      I. Long-term Capital gains, if any which have been included in the “Gross Total Income”.
      II. All deductions permissible under Sections 80C to 80U excepting deduction under Section 80G.
      III. Exempted Income.
      IV. Income of NRIs and Foreign Companies under Sections 115A, 115AB, 115AC, 115ACA or 115AD.
   — Quantum of deduction: Aggregate of deduction permissible under clauses (A), (B), (C) & (D).

Illustration:
If Mr. ‘A’ had income against the following heads,

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable salary income</td>
<td>40,000</td>
</tr>
<tr>
<td>Income from house property</td>
<td>75,000</td>
</tr>
<tr>
<td>Income from other sources</td>
<td>20,000</td>
</tr>
<tr>
<td>Interest on securities of DCM Ltd. (Gross)</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td>1,43,000</td>
</tr>
</tbody>
</table>
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

His taxable income for assessment year 2012-13 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
- Deduction permissible: Donation under Section 80G 13,500
  - (as worked out below)

Taxable income 1,27,500

Income-tax on ₹ 1,27,500 NIL

Net tax payable (including Education cess @ 3%) 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:**

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross total income</td>
<td>1,43,000</td>
</tr>
<tr>
<td>Less: Deduction under Sections 80C to 80U</td>
<td>2,000</td>
</tr>
<tr>
<td>Adjusted gross total income</td>
<td>1,41,000</td>
</tr>
</tbody>
</table>

(i) Donation on which qualifying limit is not applicable:

- (A) Allowed @ 100%
  - I. Prime Minister’s National Relief Fund 2,500

- (B) Allowed @ 50%
  - I. Indira Gandhi Memorial Trust (4000) 2,000

(ii) Donation to which qualifying limit is applicable:

- (1) For promotion of family planning 4,000
- (2) Charitable trust 10,000

Limited to 10% of Adjusted Gross Total Income:

- ₹ 14,100/- Since donation to family planning
are lowest than maximum allowable. Therefor allowable amount is (4,000 + 5,000) ₹ 9,000/- 9,000
Total Deduction for Section 80G 13,500

6.29 DEDUCTION IN RESPECT OF RENT PAID (SECTION 80GG)

Deductions admissible under this Section is:
— Actual rent paid less 10% of 'Adjusted Total Income'.
— 25% of such 'Adjusted Total Income'.
— Amount calculated at ₹ 2,000 p.m.

whichever is least.

Adjusted Total Income means the Gross total income as reduced by long term capital gain if inculed in the gross total income and income referred to in section 115A to 115D and the amount of deduction under section 80C other than deduction under this section.

However, certain conditions as given below are required to be fulfilled/satisfied for claiming deduction u/s 80GG
— The assessee should not be receiving any house rent allowance exempt u/s 10(13A) or rent free accommodation.
— The accommodation should be occupied by the assessee for the purpose of his own residence.
— The assessee fulfills such other conditions or limitations as may be prescribed having regard to the area or place in which such accommodation is situated and other relevant consideration.
— The assessee or his spouse or his minor child or an HUF of which he is a member does not own any accommodation at the place where he ordinarily resides or performs duties of his office or employment or carries on his business or profession.
— If the assessee owns any accommodation at any place other than that referred to above, such accommodation should not be in the occupation of the assessee and its annual value is not required to be determined under Section 23(2)(a)(i) or Section 23(2)(b).
— Allowed only to an individual assessee after furnishing Form 10BA along with return of income.

6.30 DEDUCTION IN RESPECT OF CERTAIN DONATIONS FOR SCIENTIFIC RESEARCH OR RURAL DEVELOPMENT (SECTION 80GGA)

An assessee (other than an assessee whose gross total income includes income chargeable under the head “profits and gains of business or profession”) is entitled to 100% deduction in the computation of his total income in respect of the following payments/donations:

(a) Sums paid to a research association which has, as its object the undertaking of scientific research, or to a university, college or other institution to be used for scientific research where such association, university, college or institution has been approved by the prescribed authority for the purpose of Section 35(1)(ii).
(b) As inserted by Finance (No. 2) Act, 1991 with effect from 1.4.1992, any sum paid by the assessee in the previous year to a research association which has as its object the undertaking of research in social science or statistical research or to a University or college or other institution to be used for social science or statistical research where such such association or university college or institution is for the time being approved by the prescribed authority for the purpose of Section 35(1)(iii).

(c) Sums paid to an approved association or institution which has as its object the undertaking of any programme of rural development, to be used for the purposes of carrying out any programme of rural development approved for the purposes of Section 35CCA provided the assessee furnishes the certificate referred to in Section 35CCA(2).

(d) Sums paid to an approved association or institution which has as its object the undertaking of any programme of rural development provided the assessee furnishes a certificate referred to in Section 35CCA(2A).

(e) As inserted by the Finance (No. 2) Act, 1991 from the assessment year 1992-93, any sum paid by the assessee in the previous year to a public sector company or a local authority or an association or institution approved by the National Committee for carrying out any eligible project or scheme, provided the assessee furnishes a certificate referred to in Section 35AC(2)(a).

For the purposes of this clause, ‘National Committee’ means the committee constituted by the Central Government from amongst persons of eminence in public life, in accordance with the rules made under Income-tax Act, 1961 and “eligible project or scheme” means such project or scheme for promoting the social and economic welfare of, or the uplift of, the public as may be notified by Central Government on the recommendations of the National Committee.

(f) Sums paid before April 1, 2002 to an approved association or institution which has as its object the undertaking of any programme of conservation of natural resources or afforestation to be used for carrying out any programme of conservation of natural resources or of afforestation approved under Section 35CCB(2).

(g) Sums paid to the National Fund for Rural Development set up and notified by the Central Government for the purpose of carrying out rural development. This section also provides that where deduction under this section is claimed and allowed, deduction will not be allowed in respect of the same payment under any other provision of the Act for the same or any other assessment year.

(h) any sum paid by the assessee in the previous year to the National Urban Poverty Eradication Fund set up and notified by the Central Government.

6.31 DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY COMPANIES TO POLITICAL PARTIES OR AN ELECTORAL TRUST(SECTION 80GGB)

Any sum contributed by an Indian Company in the previous year to any political party or to an electoral trust shall be allowed as deduction while computing its total income.
6.32 DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY ANY PERSON TO POLITICAL PARTIES OR AN ELECTORAL TRUST (SECTION 80GGC)

Any amount of contribution made by an assessee being any person, except local authority and every artificial juridical person wholly or partly funded by the Government shall be allowed as deduction while computing the total income of such person.

6.33 DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM INDUSTRIAL UNDERTAKINGS OR ENTERPRISE ENGAGED IN INFRASTRUCTURE DEVELOPMENT (SECTION 80-IA)

A deduction will be allowed from gross total income to an assessee in respect of profits and gains derived from any business of:

(1) *Infrastructure facility:* The enterprise is carrying on the business of operating any infrastructure facility which fulfills the following conditions:

(a) It is owned by an Indian company or consortium of companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act registered in India;

(b) It enters into an agreement with the Central or State Government or a local authority or any other statutory body for (i) developing, (ii) operating and maintaining, (iii) developing, operating and maintaining, a new infrastructure facility.

(c) It 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 31.3.2009 by Finance Act, 2006.

(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 2006. Now has been extended upto 31.3.2012 by Finance Act, 2011;

(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 2006. Now has been extended upto 31.3.2012 by Finance Act, 2011;

(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, 2006. Now has been extended upto 31.3.2012 by Finance Act, 2011.

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
(i) Such undertaking must be owned by an Indian Company, formed before 30.11.2005 with majority equity participation by public sector companies for the purpose of enforcing the security interest of the lenders to the company owning the power generation plant.
(ii) Such Indian Company is notified before 31.12.2005 by the Central Government for the purposes of this clause and begins to generate or transmit or distribute power before 31.3.2011 (w.r.e.f 1st April 2008 by Finance Act 2009.

Option to claim deduction: The assessee, at his option, can claim deduction in any ten consecutive assessment years out of fifteen years beginning from the year in which it begins operations.

If the assessee is engaged in infrastructure facility mentioned in (b) above he can claim deduction in any ten consecutive assessment years out of twenty years instead of out of fifteen years.

Computation of Income for Deduction: For the purpose of computing the deduction at the specified percentage for the assessment year immediately succeeding the initial assessment year and any subsequent assessment year, the profits and gains will be computed as if such business were the only source of income of the assessee in all the assessment years for which the deduction at the specified percentage under this section is available.

It means if the loss or any allowance (e.g., depreciation allowance) of such business is set-off against any other income in an earlier assessment year to find out the income of the current year for deduction under this section the loss so set-off shall be deducted from the current year’s income and on the balance so arrived, the deduction shall be computed.

Where goods held for the purpose of eligible business are transferred to any other business of the assessee, or vice-versa, such transfer is required to be done at the market value of such goods. If such goods are not transferred at market value on the date of transfer, then the profits and gains of such eligible business shall be recomputed as if transfer has been made at the market value of such goods, as on that date.
If in the opinion of the Assessing Officer, such recomputation presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

Market value here means the price that such goods would ordinarily fetch on sale in the open market.

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).

6.34 DEDUCTION IN RESPECT OF PROFIT AND GAINS BY AN UNDERTAKING A ENTERPRISE ENGAGED IN DEVELOPMENT OF SPECIAL ECONOMIC ZONE [SECTION 80-IAB]

According to Section 80-IA(13), any undertaking which develops notified SEZ on
or after 1.4.2005, will not be eligible to claim deduction u/s 80-IA.

Now, those undertaking, which develops SEZ, notified on or after 1.4.2005 under the special economic zones Act, 2005 will be eligible to claim deduction under the new Section 80-IAB.

Quantum of deduction: The deduction shall be allowed of an amount equal to 100% the profit and gains derived from such business for 10 consecutive assessment years, out of 15 years beginning from the year in which a SEZ has been notified by the central government, at option of the assesses.

6.35 DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM CERTAIN INDUSTRIAL UNDERTAKINGS OTHER THAN INFRASTRUCTURE DEVELOPMENT UNDERTAKINGS [SECTION 80-IB]

The deduction under section 80-IB is available to an assessee whose gross total income includes profits and gains derived from the following business. The deduction equal to such percentage and for such number of assessment years as given below:

<table>
<thead>
<tr>
<th>Deduction under Section 80-IB is available to different industrial undertakings as follows:</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) business of an industrial undertaking</td>
</tr>
<tr>
<td>(ii) operation of ship</td>
</tr>
<tr>
<td>(iii) hotels</td>
</tr>
<tr>
<td>(iv) Scientific research</td>
</tr>
<tr>
<td>(v) production of mineral oil</td>
</tr>
<tr>
<td>(vi) developing and building housing projects.</td>
</tr>
<tr>
<td>(vii) Cold Chain facility for agriculture produce.</td>
</tr>
<tr>
<td>(viii) Multiplex theaters.</td>
</tr>
<tr>
<td>(ix) Convention Centre</td>
</tr>
<tr>
<td>(x) Hospital in Rural area.</td>
</tr>
<tr>
<td>(xi) Hospital anywhere in India.</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Industrial Undertaking</th>
<th>Period within which production should start</th>
<th>Period of deduction (commencing from initial assessment year)</th>
<th>%age of profit eligible for deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Any industrial undertaking</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Owned by a company</td>
<td>1.4.1991 to 31.3.1995* (or any further notified period)</td>
<td>Ten consecutive assessment year</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>Owned by a co-operative society</td>
<td></td>
<td>Twelve consecutive assessment year</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>Any other assessee</td>
<td></td>
<td>Ten consecutive assessment year</td>
<td>25%</td>
</tr>
</tbody>
</table>

*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 | Next five years | 100% |
| Owned by a co-operative society | | First five years | Next seven years | 100% |
| Any other assessee | | First five years | Next five years | 100% |
*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.

(1) Industrial undertaking located in notified industrially backward districts of Category A

<table>
<thead>
<tr>
<th>Owned by a company</th>
<th>1.10.1994 to 31.3.2004</th>
<th>First five years</th>
<th>Next five years</th>
<th>100%</th>
<th>30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owned by a co-operative society</td>
<td>1.10.1994 to 31.3.2004</td>
<td>First five years</td>
<td>Next seven years</td>
<td>100%</td>
<td>25%</td>
</tr>
<tr>
<td>Any other assessee</td>
<td>1.10.1994 to 31.3.2004</td>
<td>First five years</td>
<td>Next five years</td>
<td>100%</td>
<td>25%</td>
</tr>
</tbody>
</table>

(2) Industrial undertaking located in notified industrially backward districts of Category B

<table>
<thead>
<tr>
<th>Owned by a company</th>
<th>1.10.1994 to 31.3.2004</th>
<th>First three years</th>
<th>Next five years</th>
<th>100%</th>
<th>30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owned by a co-operative society</td>
<td>1.10.1994 to 31.3.2004</td>
<td>First three years</td>
<td>Next nine years</td>
<td>100%</td>
<td>25%</td>
</tr>
<tr>
<td>Any other assessee</td>
<td>1.10.1994 to 31.3.2004</td>
<td>First three years</td>
<td>Next five years</td>
<td>100%</td>
<td>25%</td>
</tr>
</tbody>
</table>

II. Deduction under this section shall also be available in the case of the business of a ship @ 30% of the profits and gains derived from such ship for a period of ten consecutive assessment years including the initial assessment year.

However, to claim deduction it is required that the ship—

(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.

III. The deductions under this section is available to any hotel as follows:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Type of Hotel</th>
<th>Period within which functioning should start</th>
<th>Period of deduction (commencing from initial assessment year)</th>
<th>Profit eligible for deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Hotel located in a hilly area or a rural area or a place of</td>
<td>1.4.1990 to 31.3.1994</td>
<td>Ten consecutive years</td>
<td>50%</td>
</tr>
</tbody>
</table>
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

| (ii) | Hotel located in a hilly area or a rural area or a place of pilgrimage or any other place notified by Central Government. However, such hotel should not be located within Municipal Jurisdiction of Calcutta, Chennai, Delhi and Mumbai. Such hotel should however be approved by the prescribed authority. | 1.4.1997 to 31.3.2001 | Ten consecutive years | 50% |
| (iii) | Hotel located in any place other than those mentioned in (i) above | 1.4.1991 to 31.3.1995 | Ten consecutive years | 30% |
| (iv) | Hotel located in any other place other than those mentioned in (i) above. However, such hotel should not be located within Municipal Jurisdiction of Calcutta, Chennai, Delhi and Mumbai. | 1.4.1997 to 31.3.2001 | Ten consecutive years | 30% |

However, the following conditions need to be satisfied by a hotel in order to claim deduction:

(i) The business of the hotel is not formed by the splitting up; or the reconstruction of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose.

(ii) The business of hotel is owned and carried on by a company registered in India with a paid up capital of not less than ₹ 5 lakhs.

(iii) The hotel is for the time being approved by the prescribed authority. Any hotel approved before 1.4.99 shall be deemed to have been approved for the purpose of this section.

**IV. Deduction in the case of any company carrying on scientific research and development** is available @ 100% of the profits and gains of such business for a period of five assessment years beginning from the initial assessment year. However, to claim deduction under this section, it is required that such a company—
(i) is registered in India.

(ii) has the main object of scientific and industrial research and development.

(iii) is for the time being approved by the prescribed authority at any time before 1.4.1999.

Further, the amount of deduction in the case of any company carrying on scientific research and development shall be hundred per cent of the profits and gains of such business for a period of ten consecutive assessment years, beginning from the initial assessment year, if such company—

(i) is registered in India;

(ii) has its main object the scientific and industrial research and development;

(iii) is for the time being approved by the prescribed authority at any time after the 31st day of March, 2000, but before the 1st day of April, 2007;

(iv) fulfills such other conditions as may be prescribed.

V. Industrial undertaking producing or refining mineral oil in the North Eastern Region or in any part of India:

The amount of deduction to an undertaking shall be 100% of the profits for a period of seven consecutive assessment years, including the initial assessment year, if such undertaking fulfils any of the following conditions:

(i) is located in North-Eastern Region and has begun or begins commercial production of mineral oil before the 1st day of April, 1997;

(ii) is located in any part of India and has begun or begins commercial production of mineral oil on or after the 1st day of April, 1997;

Provided that the provisions of this clause shall not apply to blocks licensed under a contract awarded after the 31st day of March, 2011 under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated the 10th February, 1999 or in pursuance of any law for the time being in force or by the Central or a State Government in any other manner;

(iii) is engaged in refining of mineral oil and begins such refining on or after the 1st day of October, 1998 but not later than 31st day of March 2012..(w.e.f Assessment year 2001-02) (the words "but not later than the 31st day of March, 2012" shall be inserted w.r.e.f 1st April 2009);

(iv) is engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts (hereafter referred to as "NELP-VIII") under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 and begins commercial production of natural gas on or after the 1st day of April, 2009.

(v) is engaged in commercial production of natural gas in blocks licensed under the IV round if bidding for award of exploration contracts for Coal Bed Methane blocks and begins commercial production of natural gas on or after
the 1st day of April 2009.

Explanation: All blocks licensed under a single contract, which has been awarded under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 or has been awarded in pursuance of any law for the time being in force or has been awarded by Central or a State Government in any other manner, shall be treated as a single undertaking.

VI. 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.

VII. **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:**

<table>
<thead>
<tr>
<th>Industrial Undertaking</th>
<th>Period within which production should start</th>
<th>Period of deduction (commencing from initial assessment year)</th>
<th>%age of profit eligible for deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>For a company</td>
<td>1.4.1999 to 31.3.2003</td>
<td>First five years</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Next five years</td>
<td>30%</td>
</tr>
<tr>
<td>For a co-operative society</td>
<td></td>
<td>First five years</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Next seven years</td>
<td>25%</td>
</tr>
<tr>
<td>Any other assessees</td>
<td></td>
<td>First five years</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Next five years</td>
<td>25%</td>
</tr>
</tbody>
</table>

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.

VIII. **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.

IX. 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.

X. 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.

XI. 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 subsection (2) of section 288, certifying that the deduction has been correctly claimed.
Test Your Knowledge

1. Deduction under Section 80-IB is available to:
   (a) Charitable Trust
   (b) Tour and Travels
   (c) Industrial Research
   (d) Convention Centre

Correct answer: (c) and (d)

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

Correct answer: (a) and (b)

6.36 SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS OR ENTERPRISES IN CERTAIN SPECIAL CATEGORY STATES [SECTION 80-IC]

(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in Sub-section (2), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains, as specified in Sub-section (3).

(2) This section applies to any undertaking or enterprise,—
   (a) which has begun or begins to manufacture or produce any article or thing, not being any article or thing specified in the Thirteenth Schedule, and undertakes substantial expansion during the period beginning—
      (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in any specified areas, in the State of Sikkim; or
      (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any specified areas, in the State of Himachal Pradesh or the State of 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 North-Eastern States.

(3) The deduction referred to in Sub-section (1) shall be—

(i) in the case of any undertaking or enterprise referred to in Sub-clauses (i) and (iii) of Clause (a) or Sub-clause (i) and (iii) of Clause (b), of Sub-section (2), 100% of such profits and gains for ten assessment years commencing with the initial assessment year;

(ii) in the case of any undertaking or enterprise referred to in Sub-clause (ii) of Clause (a) or Sub-clause (ii) of Clause (b), of Sub-section (2), 100% of such profits and gains for five assessment years commencing with the initial assessment year and thereafter, 25% (or 30% where the assessee is a company) of the profits and gains.

(4) This section applies to any undertaking or enterprise which fulfils all the following conditions, namely:—

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

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

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

Explanation.—The provisions of Explanations 1 and 2 to Sub-section (3) of Section 80-IA shall apply for the purposes of Clause (ii) of this sub-section as they apply for the purposes of Clause (ii) of that sub-section.

(5) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or in Section 10A or Section 10B, in relation to the profits and gains of the undertaking or enterprise.

(6) Notwithstanding anything contained in this Act, no deduction shall be allowed to any undertaking or enterprise under this section, where the total period of deduction inclusive of the period of deduction under this section, or under the second proviso to Sub-section (4) of Section 80-IB or under Section 10C, as the case may be, exceeds ten assessment years.
(7) The provisions contained in Sub-section (5) and Sub-sections (7) to (12) of Section 80-IA shall, so far as may be, apply to the eligible undertaking or enterprise under this section.

(8) For the purposes of this section,—

(i) “Industrial Area” means such areas, which the Board, may by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(ii) “Industrial Estate” means such estates, which the Board may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(iii) “Industrial Growth Centre” means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(iv) “Industrial Park” means such parks, which the Board, may by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(v) “initial assessment year” means the assessment year relevant to the previous year in which the undertaking or the enterprise begins to manufacture or produce articles or things, or commences operation or completes substantial expansion;

(vi) “Integrated Infrastructure Development Centre” means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(vii) “North-Eastern States” means the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura;

(viii) “Software Technology Park” means any park set up in accordance with the Software Technology Park scheme notified by the Government of India in the Ministry of Commerce and Industry;

(ix) “substantial expansion” means increase in the investment in the plant and machinery by at least fifty per cent of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken;

(x) “Theme Park” means such parks, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government.

6.37 DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM THE BUSINESS OF COLLECTING AND PROCESSING BIO-DEGRADABLE WASTE (SECTION 80-JJA)

The section provide that where the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas, making pellets or briquette for fuel or organic manure.
**Amount of Deduction:**

There shall be allowed in computing the total income of the assessee, a deduction of an amount equal to the whole of such profit and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.

**6.38 Deduction in respect of employment of new workmen (Section 80-JJAA)**

In order to encourage the employers to further generate more employment opportunities, a new Section 80JJAA has been inserted by Finance (No. 2) Act, 1998 w.e.f. assessment year 1999–2000:

- the assessee should be an Indian Company;
- its gross total income should include profits and gains derived from an industrial undertaking;
- the industrial undertaking should be engaged in the manufacture or production of any article or thing;
- the industrial undertaking should not have been formed by splitting up or reconstruction of an existing undertaking or amalgamation with another industrial undertaking;
- the assessee furnishes alongwith the return of income a report of chartered accountant in form No. 10DA;
- in case of a new industrial undertaking, in the first previous year, it employs more than 100 regular workmen;
- in the case of an existing industrial undertaking, the number of regular workmen employed during the relevant previous year is equal to atleast 110% of the regular workmen employed in such undertaking as on the last day of the preceding year.

**Amount of Deduction:**

If the aforementioned conditions are satisfied the assessee shall be allowed a deduction of an amount equal to 30% of additional wages paid to the new regular workmen employed by the assessee in the previous year for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

**Regular workmen does not include:**

1. a casual workman
2. a workman employed through contract labour
3. any other workman employed for a period less than 300 days during the previous year.

**6.39 DEDUCTION IN RESPECT OF CERTAIN INCOMES OF OFFSHORE BANKING UNITS (SECTION 80LA)**

(1) Where the gross total income of an assessee,—

(i) being a scheduled bank, or any bank incorporated by or under the laws of a country outside India,
(ii) **Quantum of deduction:**

Owning an offshore banking unit in a special economic zone, includes any income referred to in Sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to—

(a) 100% of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission, under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949), was obtained, and thereafter;

(b) 50% of such income for next five consecutive assessment years.

(2) **Income in respect of which deduction is allowed:** The income referred to in Sub-section (1) shall be the income—

(a) from an offshore banking unit in a special economic zone;

(b) from the business, referred to in Sub-section (1) of Section 6 of the Banking Regulation Act, 1949 (10 of 1949), with an undertaking located in a special economic zone or any other undertaking which develops, develops and operates or operates and maintains a special economic zone;

(c) received in convertible foreign exchange, in accordance with the regulations made under the Foreign Exchange Management Act, 1999 (42 of 1999).

(3) **Conditions to be satisfied:** No deduction under this section shall be allowed unless the assessee furnishes along with the return of income,—

(i) in the prescribed form (Form No. 10CCF), i.e., the report of a accountant as defined in the **Explanation** below Sub-section (2) of Section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section; and

(ii) a copy of the permission obtained under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949), in case of a offshore Banking Unit.

**Explanation.**—For the purposes of this section,—

(a) “convertible foreign exchange” shall have the same meaning assigned to it in clause (a) of the **Explanation** below Sub-section (4C) of Section 80HHC;

(b) “Offshore Banking Unit” means a branch of a bank in India located in the special economic zone and has obtained the permission under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949);

(c) “scheduled bank” shall have the same meaning assigned to it in Clause (e) of Section 2 of the Reserve Bank of India Act, 1934 (2 of 1934);

(d) “special economic zone” shall have the same meaning assigned to it in Clause (viii) of the **Explanation 2** to Section 10A.”

6.40 DEEDUCTION IN RESPECT OF INCOME OF CO-OPERATIVE SOCIETIES

(SECTION 80P)

The deduction is allowable in respect of following incomes, which are included in gross total income of co-operative societies:
A. 100% of the profits of a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to
   — The government or a local authority; or
   — A government company or a statutory corporation; or
   — A federal co-operative society, engaged in the business of supplying the above-said products.

B. 100% of the profits of co-operative society engaged in any one of the following activities:
   — Carrying on the business of banking or providing credit facilities to its member, or
   — A cottage industry, or
   — The marketing of agricultural produce grown by its members, or
   — The purchase of agricultural implements for the purpose of supplying them to its members, or
   — The processing, without the aid of power, of agricultural produce of its members, or
   — The collective disposal of the labour of its member, or
   — Fishing or allied activities for the purpose of supplying them to its members.

Provided, in the case of last two types of co-operative societies, the deduction, is available subject to the condition that the rules and bye-laws of the society restrict the voting rights to the members like, State Government, Co-operative Credit Society which provide financial assistance to the society and individual, who contributes their labours.

W.e.f. Assessment Year 2007-08 this exemption is not be available to co-operative banks other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

C. Profits and gains of co-operative society other than those specified in A and B above is exempt up to the specified limits:
   — in case of a consumer co-operative society — ₹ 1,00,000
   — in any other case — ₹ 50,000

D. All profits by way of interest or dividend from its investment with any other co-operative society.

E. 100% of income or profit of a Co-operative Society from the letting of godowns or warehouse for storage, processing or facilitating the marketing of commodities.

F. A co-operative society, not being a housing society or an urban consumers society or a society carrying on transport business or a society engaged in the performance of any manufacturing operation with the aid of power, where the gross total income does not exceeds ₹ 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.
6.41 DEDUCTION IN RESPECT OF ROYALTY INCOME, ETC., OF AUTHORS OF CERTAIN BOOKS OTHER THAN TEXT BOOKS (SECTION 80QQB)

No deduction under this section shall be allowed unless an assessee furnishes a certificate in the prescribed form 10CCD/10H.

Where in case of an assessee, being an individual, who is
— Resident in India
— an author of a book other than textbooks
— income must be derived from such profession
— income must be either lump sum consideration or royalty copyright fees.

Amount of deduction:

His gross total income of the previous year includes royalty or the copyright fees, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of 100% of such income or Rs. 300,000, whichever is less.

Further, where income by way of such royalty or copyright fees is not a lump sum consideration in lieu of all rights of the assessee is the book, than such royalty, etc. before allowing expenses, in excess of 15% of the value of such books sold during the previous year, shall be ignored.

Provided further that in respect of any income earned from any sources outside India, so much of the income, shall be taken into account for the purpose of this section as is brought into India by, or on behalf of, the assessee in convertible foreign exchanges within the period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf.

Certificates to be furnished:

(a) No deduction under this section shall be allowed unless the assessee furnishes a certificate in the prescribed form (form No. 10CCD) duly signed by the prescribed authority, along with the return of income setting forth such particulars as may be prescribed.

(b) No deduction under this section shall be allowed is respect of any income earned from any sources outside India, unless the assessee furnishes a certificate in the prescribed form (form No. 10H) from prescribed authority, as may be prescribed, along with the return of income.

No double deduction: Where a deduction for any previous year has been claimed and allowed in respect of any income referred to in this section, no deduction in respect of such income shall be allowed, under any other provision of the Act in any assessment year.

6.42 DEDUCTION IN RESPECT OF ROYALTY ON PATENTS (SECTION 80RRB)

(1) Where in the case of an assessee, being an individual, who is—

(a) resident in India;
(b) a patentee;

c) in receipt of any income by way of royalty in respect of a patent registered on or after the 1st day of April, 2003 under the Patents Act, 1970, and

his gross total income of the previous year includes royalty, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of 100% of such income or Rs. 300,000, whichever is less.

Provided that where a compulsory licence is granted in respect of any patent under the Patent Act, 1970, the income by way of royalty for the purpose of allowing deduction under this section shall not exceed the amount of royalty under the terms and conditions of a licence settled by the Controller under that Act:

Provided further that in respect of any income earned from any sources outside India, so much of the income, shall be taken into account for the purpose of this section as is brought into India by, or on behalf of, the assessee in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf.

(2) Certificates to be furnished:

(a) No deduction under this section shall be allowed unless the assessee furnishes a certificate in the prescribed form (Form No. 10CCD), duly signed by the prescribed authority, along with the return of income setting forth such particulars as may be prescribed.

(b) No deduction under this section shall be allowed in respect of any income earned from any source outside India, unless the assessee furnishes a certificate in the prescribed form (Form No. 10H), from the authority or authorities, as may be prescribed, along with the return of income.

(3) No Double deduction: Where a deduction for any previous year has been claimed and allowed in respect of any income referred to in this section, no deduction in respect of such income shall be allowed, under any other provision of this Act in any assessment year.

Explanation.—For the purposes of this section,—

(a) “Controller” shall have the meaning assigned to it in clause (b) of Sub-section (1) of Section 2 of the Patents Act, 1970;

(b) “lump sum” includes an advance payment on account of such royalties which is not returnable;

(c) “patent” means a patent (including a patent of addition) granted under the Patents Act, 1970;

(d) “patentee” means the person, being the true and first inventor of the invention, whose name is entered on the patent register as the patentee, in accordance with the Patents Act, 1970, and includes every such person, being the true and first inventor of the invention, where more than one person
is registered as patentee under that Act in respect of that patent;

(e) “patent of addition” shall have the meaning assigned to it in clause (q) of Sub-section (1) of Section 2 of the Patents Act, 1970;

(f) “patented article” and “patented process” shall have the meanings respectively assigned to them in clause (o) of Sub-section (1) of Section 2 of the Patents Act, 1970;

(g) “royalty”, in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head “Capital gains” or consideration for sale of product manufactured with the use of patented process or of the patented article for commercial use) for—

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent; or

(ii) the imparting of any information concerning the working of, or the use of, a patent; or

(iii) the use of any patent; or

(iv) the rendering of any services in connection with the activities referred to in Sub-clauses (i) to (iii);

(h) “true and first inventor” shall have the meaning assigned to it in Clause (y) of Sub-section (1) of Section 2 of the Patents Act, 1970.

6.43 DEDUCTION IN CASE OF A PERSON WITH DISABILITY (SECTION 80U)

(1) Amount of deduction:

In computing the total income of an individual, being a resident, who, at any time during the previous year, is certified by the medical authority to be

— a person with disability, there shall be allowed a deduction of a sum of ₹50,000; or

— a person with severe disability shall be allowed a deduction of a sum of ₹1,00,000.

(2) Every individual claiming a deduction under this section shall furnish a copy of the certificate issued by the medical authority in the form and manner, as may be prescribed, along with the return of income under Section 139, in respect of the assessment year for which the deduction is claimed:

Provided that where the condition of disability requires reassessment of its extent after a period stipulated in the aforesaid certificate, no deduction under this section shall be allowed for any assessment year relating to any previous year beginning after the expiry of the previous year during which the aforesaid certificate of disability had expired, unless a new certificate is obtained from the medical authority in the form and manner, as may be prescribed, and a copy thereof is furnished along with the return of income under Section 139.

Explanation.—For the purposes of this section,—

(a) “disability” shall have the meaning assigned to it in clause (i) of Section 2 of
the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 and includes "autism", "cerebral palsy" and "multiple disabilities" referred to in clauses (a), (c) and (h) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;

(b) "medical authority" means the medical authority as referred to in clause (p) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995, or such other medical authority as may, by notification, be specified by the Central Government for certifying "autism", "cerebral palsy", "multiple disabilities", "person with disability" and "severe disability" referred to in clauses (a), (c), (h), (q) and (o) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;

(c) "person with disability" means a person referred to in clause (t) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995, or clause (j) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;

(d) "Person with severe disability" means:
   (i) a person with eighty per cent or more of one or more disabilities, as referred to in Sub-section (4) of Section 56 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995; or
   (ii) a person with severe disability referred to in clause (o) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999.

6.44 RELIEF AND REBATE IN RESPECT OF INCOME-TAX AND RATES OF INCOME-TAX

In addition to the provisions for aggregation discussed earlier, Section 66 lays down that in computing the total income of any assessee, there shall be included certain items of income on which no income-tax is payable under Chapter VII. Accordingly the provisions of Section 86 would be applicable.

6.45 SHARE OF MEMBER OF AN ASSOCIATION OF PERSONS OR BODY OF INDIVIDUALS IN THE INCOME OF THE ASSOCIATION OR BODY (SECTION 86)

This section as substituted by the Finance Act, 1992 with effect from the assessment year 1993-94 provides that no income tax shall be payable by the assessee who is a member of an association of persons or body of individuals (other than, a company or a co-operative society or a society registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India) in respect of his share in the income of such association or body computed in the manner provided in Section 67A of the Act.

Further, where the association or body is chargeable to tax at the maximum marginal rate or any higher rate under any of the provisions of this Act, the share of a
member computed as aforesaid shall not be included in his total income. However, in any other case, the share of a member shall form part of his total income.

It is also provided that where no income-tax is chargeable on the total income of the association or body. The share of a member computed as aforesaid shall be chargeable to tax as part of his total income and nothing contained in this section shall apply to the case.

6.46 INCOME FROM AN ASSOCIATION OF PERSONS OR A BODY OF INDIVIDUALS (SECTION 86)

Where the assessee is a member of an association of persons or body of individuals other than a company or a co-operative society or a society registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India), income-tax shall not be payable by the assessee in respect of his share in the income of the association or body computed in the manner provided in Section 67A that —

(a) where the association or body is chargeable to tax on its total income at the maximum marginal rate or any higher rate, under any of the provisions of this Act, the shares of a member computed as aforesaid shall not be included in his total income;

(b) in any other case, the share of a member computed as aforesaid shall form part of his total income;

Provided further that where no income-tax is chargeable on the total income of the association or body, the share of a member computed as aforesaid shall be chargeable to tax as part of his total income and nothing contained in this section apply to the case.

6.47 RELIEF WHEN SALARY IS PAID IN ARREARS OR IN ADVANCE [SECTION 89]

It has been explained earlier that arrears and advances of salary are assessed in the hands of the employee in the year they are received. Consequently, in a financial year, an employee may become chargeable to tax in respect of salary for more than twelve months. Likewise, any payment in the nature of profit in lieu of salary [Section 17(3)] is also chargeable in the year of receipt or the year when it became due in addition to the normal salary received by him. In consequence the income swells and the average rate of tax too. In order to remove this hardship, the Assessing Officer has been empowered to grant relief in appropriate cases in accordance with Rule 21AA of the Income-tax Rules, 1962.

Provided that no such relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company referred to in subclause (i) of clause (10C) of section 10, a scheme of voluntary separation, if an exemption in respect of any amount received or receivable on such voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee under clause (10C) of section 10 in respect of such, or any other, assessment year.
6.48 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.

### LESSON ROUND UP

- At first Section 60 to 65 of the Income Tax Act dealing with clubbing of income has been discussed.
- Tax treatment of Losses from same head and losses under various heads has been discussed in detail, especially carry-forward and set-off of accumulated loss and unabsorbed depreciation allowance in the scheme of amalgamation of a banking company.
- Later deductions with respect to certain investments or payments from Gross Total Income of an assessee is discussed.
- Relief and rebate specified in the Income Tax, 1961 especially in relation to association of persons or body of individuals is being discussed.

### SELF TEST 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.


5. Outline the circumstances under which and the conditions subject to which the total income of an individual should be taken to include the share of income of his/her spouse from a concern in which such individual has substantial interest.

6. What do you mean by "Set-off and carry forward of losses"? Which losses can be carried forward?

7. Write short notes on:
   (i) Set-off of losses from one source against income from the same source.
   (ii) Set-off of losses against income under the same head.
   (iii) Losses in speculation business
   (iv) Losses of registered firms.
   (v) Carry-forward and set-off of losses in the case of companies.

8. Discuss the provisions of the Income-tax Act relating to the set-off of losses.

9. Discuss the provisions of the Income-tax Act relating to carry-forward and set-off of losses, with particular reference to the provisions of Section 72A of the Act.

10. Enumerate the various deductions allowable to individuals from their total income in respect of their incomes and payments.

11. Enumerate the various rebates and reliefs available to individuals under the Income-tax Act, 1961.

12. What are the different kinds of incomes which are included in the total income but on which no income-tax is payable?

13. What conditions are to be satisfied in order to claim a deduction for donations made to certain funds or/and charitable institutions? Illustrate.

14. Write a short note on the rebate available under Sections 88B and 88C.

15. Explain in brief the deduction for the medical insurance premium paid by the assessee.
In this chapter the Income Tax Treatment with relation to individuals, HUF, Firms, Associations of Persons, Cooperative Societies and Non-residents is being discussed. The tax implications, rates of tax and other issues relating to the above persons have been discussed elaborately. With regard to firms the focus is on partnership firms or Limited liability partnerships. A special feature on “Tonnage tax system” is also discussed. Under the globalised economy, taxation of non-residents in India is also discussed.

**LEARNING OBJECTIVES**

This chapter covers the following topics:

- Taxation of Individuals
- Taxation of Hindu Undivided Families
- Computation of Income of the H.U.F.
- Partition of a Hindu undivided family (Section 171)
- Assessment after partition (Section 171)
- A partition of the HUF can be both total and partial
- Taxation of Firms
  1. Scheme of taxation of a firm and its partners
  2. Change in Constitution of a Firm (Section 187)
  3. Losses of Registered Firms (Section 75)
  4. Assessment of Partners
  5. Succession of one firm by another firm (Section 188)
  6. Special provisions relating to Retail Trade
  7. Illustrations
- Taxation of Association of Persons
  1. Meaning
  2. Formation of an Association of Persons
  3. Tax Liability of an Association of Persons
  4. Method of Computing Share of a Member of Association of Persons, etc. (Section 67A)
7.1 TAXATION OF INDIVIDUALS

The expression 'individual' has not been defined anywhere in the Income-tax Act although Section 2(31) which defines the term 'person' specifies that an individual is a person for all purposes of assessment of income-tax.

The expression 'individual' in the ordinary sense of the term should be taken to mean a human being or a single person with sound or unsound mind and may be a major or minor, married or unmarried, male or female.

All individuals are liable to income-tax in cases where their total income for the relevant accounting year(s) assessable in a particular assessment year exceeds the basic exemption limit. The tax liability of an individual to be assessed under income-tax is not in any way affected by the fact that the individual dies before his income is assessed to tax. In cases of death his legal representative is assessable to tax in the same way and to the same extent as the deceased would have been if he had been alive. In cases of individuals who are minors or are of unsound mind, the liability to tax would be on the guardian of the individual.

The total income of an individual, assessable to tax is computed under different heads of income in accordance with the relevant provisions of the Income-tax Act which were explained in earlier Study Lessons.
The Income Tax Act contains the method of computation and assessment of total income as well as the rules in this connection. The computation of tax is done according to the rates prescribed by the Finance Act which is passed annually by the Parliament. Ordinarily, the Finance Act is passed in May every year; but if there is delay in its passage, Section 294 provides that till the passage of the Finance Act, either the provisions of the Finance Act in force in the preceding financial year or the provisions of the proposed Finance Bill, whichever are more favourable to the assessee, shall be applied.

7.2 TAXATION OF HINDU UNDIVIDED FAMILIES

The term ‘Hindu undivided family’ has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income. [R. Subramania Iyer v. CIT (1955) 28, ITR, 352]. However, to become an assessee under the Income-tax Act, there must be ‘income-yielding’ joint property of the family.

A HUF may consist of a number of smaller HUFs. A smaller HUF has a legal existence and may be assessable as a unit distinct from the apex joint family even when the bigger HUF constituted of such branch with other HUFs is separately assessable [CIT v. Khanna (1963), 49, ITR, 232].

Under Hindu Law, a Joint Hindu Family consists of all persons lineally descended from a common ancestor (except those who have separated from the joint family by partitioning of assets) and includes their wives and unmarried daughters, and also a stranger who has been adopted by the family. [Surjit lal Chhabra v. CIT (1975) 101, ITR, p.776 (S.C.)].

The Supreme Court’s decision in the case of Surjit Lal Chhabra v. CIT (1975 101 ITR 776) has come to stay as one of the leading case laws. The ratio laid down by the Supreme Court had been applied by the Andhra Pradesh, Orissa and Madras High Courts, followed by Bombay, Patna, Madhya Pradesh and Delhi High Courts and relied upon by the Punjab High Court. In the latest case, the Delhi High Court held in Commissioner of Income-tax v. S.P. Chopra (1991, 191 ITR 455) that the income from the half share of the property had to be treated as the individual income of the assessee under the personal law and not as income of the family. The character of the property had to be determined in accordance with the personal law of the assessee and not on the basis of how the property had been treated by the revenue in respect of earlier assessments.

A son conceived or in his mother’s womb is equal in many respects to a son actually in existence, viz., inheritance, partition, survivorship etc. But this doctrine does not apply to the Income-tax Act. Hence, a son conceived is not treated a member of the H.U.F. for Income-tax purposes. [T.S. Srinivasan v. C.I.T., (1966) 60, ITR, p.36 (S.C.)].

Jain and Sikh undivided families are also treated as Hindu undivided families unless, under special circumstances, the assessee claims not to be treated as such. If such claim is made, the assessee shall have to prove that there is some such custom in his family on account of which it cannot be treated as a Hindu undivided family.
A Hindu does not cease to be a Hindu merely because he declared for the purpose of the Special Marriage Act, 1872, that he does not profess Hindu Religion. Such a Hindu does form an H.U.F. with his children from such marriage. [CIT v. Partap Chand (1959), 36 ITR, 262]. Similarly, a Muslim family governed by the Marumakkathayam law constitutes ‘Tarwad’ or ‘Thavazhi’ and falls within the definition of a H.U.F. [V.K.P. Abdul Kadar Haji v. Ag. ITO (1967) 66, ITR, 173].

If a Hindu gets converted as a Christian, the family of such a person will not be a HUF. However a Hindu, along with his son (by a christian wife) who has been brought up as a Hindu will be a HUF. [CWT v. R. Sridharan (1976) 104, ITR, 436 (S.C.)].

However Hindu Law is not applicable so far as Cutchi Memons’ right to property, inheritance and succession are concerned - Hajee Abdullah Sait v. CIT (1989) 177 ITR 71/47 Taxman 270 (Kar.).

A Hindu Joint Family consists of two types of members:

(i) Coparceners: The lineal male descendants of a person upto the third generation of such person are known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time.

(ii) Other members: Such members include unmarried daughters, wives of male members of the family and other male members.

Thus, a Hindu Joint Family may consist of:

(a) All persons lineally descended from a common ancestor and includes their wives and unmarried daughters.

(b) A male and widow or widows of deceased male member or members. [Gowli Buddanna v. C.I.T. (1966) 60, ITR, p. 293 (S.C.)]

(c) Husband and wife. [Prem Kumar v. CIT (1980) 121, ITR, 347].

The Allahabad High Court’s decision in the case of Prem Kumar v. CIT (1980, 121 ITR 347) had been dissented from by the Madhya Pradesh High Court in the case of CIT v. Vishnukumar Bhaiya (1983, 142 ITR 357) holding that an assessment in the status of an HUF can be made only when there are two or more members of the HUF. A single member, either male or female, cannot constitute a HUF. In the absence of a son the property which is received by a member of the HUF is his individual property and his subsequent marriage will not alter the position. Following this decision and that of the Supreme Court in the case of Surjit Lal Chhabra (Supra), the Full Bench of the Patna High Court held in the case of Commissioner of Income-tax v. Shankar Lal Budhia (1987, 165 ITR 380) that the status of an individual assessee governed by the Hindu Law would not automatically change to that of a Hindu undivided family under the Income-tax Act, 1961 merely on his marriage.

(d) Brothers only. [C. Ag v. Shyam Sunder Patnaik (1966) 60, ITR, p. 213 (S.C.)].

It may however be noted that the Supreme Court's decision in the case of CIT v. Veerappa Chettiar (1970, 76 ITR 467) was distinguished by the Supreme Court in the case of Surjit Lal Chhabra v. CIT (1975, 101 ITR 776) holding, inter alia, that the assessee, his wife and unmarried daughter were members of the Hindu undivided family and that the joint Hindu undivided family is a creature of law and cannot be created by action of parties.

However, an unmarried coparcener who receives share on the partition of joint family properties, cannot form a Hindu undivided family unless he marries. After his marriage, he can hold the property received from family as joint family property consisting of himself and his wife. [C. Krishna Prasad v. C.I.T. (1974) 97, p. 493 (S.C.).]

Karta: Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. [Narendra Kumar J. Modi v. CIT (1976) 105, ITR, 109 (S.C.).] In the absence of a male member in the family or when all male members are minors, a woman member can be treated as manager of the family for income-tax purposes. [Smt. Champa Kumari Singhi v. Addl. Member of the Board of Revenue (1962) 46, ITR, p. 81].

Joint Property of the family: It consists of:
(i) ancestral property;
(ii) accretion thereto;
(iii) acquisition with joint funds; and
(iv) self-acquired property of any member thrown by him into the common stock to be treated as family property. In the case of Pushpa Devi v. C.I.T. the Supreme Court has held that a Hindu female, not being a coparcener, cannot blend her separate property with Joint family property. However, she can make a gift of her property to the family. [(1977) 109, ITR p. 730].

The Supreme Court's decision in the case of Pushpa Devi v. Commissioner of Income-tax (1977, 109 ITR 730) had been later followed by the Calcutta, Andhra Pradesh and Madras High Courts. In the latest case, the Madras High Court held in the case of Rajathy Ammal v. Commissioner of Wealth-tax (1987, 164 ITR 605) that a female member could not throw her property into the family hotchpotch and the only way she could achieve her purpose was either by gifting it or selling to the family.

Further, Section 64(2) provides that where an individual being a member of Hindu undivided family transfers his separate property after 31st December, 1969 to the family for the common benefit of the family, otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof shall be included in the total income of the transferor individual and not in the income of the family.

School of Hindu Law: According to Hindu Law, HUFs are governed by two schools viz. Mitakshara and Dayabhaga.

Mitakshara School applies to whole of India except the states of West Bengal and Assam.
Dayabhaga school applies to the States of West Bengal and Assam. The difference between the two schools is as under:

(i) **Foundation:** In the Mitakshara School, the foundation of a coparcenary is laid down when a son is born to the Mitakshara father. Under the Dayabhaga school, the foundation of a coparcenary is laid on the death of the father leaving, as survivors, one or more sons.

(ii) **Right to partition:** A Mitakshara son, in whom the interest in family property is vested by birth, all along possesses a right to demand partition. A Dayabhaga son, on the other hand, acquires no interest in the family property by birth and, consequently, has no right to demand partition of the HUF property from his father.

(iii) **Quantum of share:** Under Mitakshara Law, each coparcener takes 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 Vallabhadas Modani v. C.I.T. (1982) 138, ITR, p. 673].

The Allahabad High Court’s decision supra in the case of Shri Vallabhadas 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.

Test Your Knowledge

Creation of a HUF is a legal phenomenon.

(a) True
(b) False

Correct answer: (b)

7.2.1 Computation of Income of the H.U.F.

The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assesses. However, in this connection the following points are worth noting:

Clubbing of Income

(i) If the funds of a Hindu Undivided family are invested in a company or a firm, fees or remuneration received by the member as a director, or a partner in the company or firm may be treated as income of the family in case the fees or remuneration is earned essentially as a result of investment of funds. But, if the fees or remuneration is earned essentially for services rendered by the
member in his personal capacity, the income shall constitute the personal income of the member.

(ii) For determining whether a particular income belongs to a member of the family or to his undivided family, the Supreme Court has enunciated certain principles. The question to be considered in such cases is, whether the remuneration received by the coparcener is in substance merely a mode of return made to the family because of the investment of the family funds in the business or whether it is a compensation for services rendered by the coparcener. If it is the former, it is an income of the HUF but if it is the latter it is the income of the individual. If the income was essentially earned as a result of the funds invested, the fact that a coparcener has rendered some service would not change the character of the receipt. But if, on the other hand, it is essentially a remuneration for the services rendered by the coparcener, the circumstances that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt the income of the HUF. [Raj Kumar Singh Hukam Chandji v. CIT (1970) 78 ITR 33].

The Supreme Court’s decision supra in the case of Raj Kumar Singh Hukam Chandji v. Commissioner of Income-tax has come to stay as one of the most followed/applied case laws. This decision had been followed by Patna (Full Bench), Allahabad, Bombay and Gujarat High Courts, applied by Andhra Pradesh, Madras, Kerala, Delhi, and Supreme Court itself. It would suffice to refer to the Supreme Court’s decision in the case of Y.L. Aggarwalla and others v. Commissioner of Income-tax (1978, 114 ITR 471) holding that the share income was a return made to the family because of the investments of the family funds in the business and the share income was not the individual income of minor sons but was the income of the Hindu undivided family and had to be assessed in the hands of the family.

(iii) Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family. [CIT v. Ashok Bhai Chiman Bhai (1965) 56, ITR, 42 (S.C.)].

(iv) The personal earning, including income from self acquired property of a member of the HUF, even though he has sons, would not be included in the income of the family. Such income shall be assessed as income of that individual. [Kalyanji Vithal Das v. CIT (1937) 5 ITR 90 (PC)].

(v) Any sum paid by an HUF to a member of the family out of its income is not deductible in computing the income of the family. However, such amount will not be included in the income of such individual whether the family had paid tax on its income or not [Section 10(2)].

(vi) If any remuneration is paid by the Hindu Undivided family to the karta or any other member for services rendered by him in conducting family’s business, the remuneration is deductible if remuneration is (a) paid under a valid and bona fide agreement; (b) in the interest of, and expedient for, the business of
family; and (c) genuine and not excessive. *Jugal Kishore Baldeo Sahai v. CIT* [1967] 63 ITR 238 (SC).

(vii) If salary is paid by the Hindu undivided family to its karta for looking after its interest in firms in which it is partner through said karta, such salary is allowable as deduction - *CIT v. Prakash Chand Agarwal* [1982] 11 Taxman 55 (MP).

(viii) Income from 'stridhan' is not 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'.

(ix) If a member has converted or transferred without adequate consideration after December 31, 1969 his self-acquired property into joint family property, income from such property is not taxable in the hands of the family.

(x) Income from impartible estate is taxable in the hands of the holder of the estate and not in the hands of the Hindu undivided family. Though, the impartible estate belongs to the family, income arising therefrom belongs to the holder of the estate who is the senior most male member of the family. Income from impartible estate is taxable in the hands of the holder of the estate.

(xi) Personal income of the members cannot be treated as income of Hindu undivided family.

(xii) Under the Dayabhaga School of law, as stated in a preceding page, no son has any right in the ancestral property during the lifetime of his father. If, therefore, the father does not have any brother as a coparcener, income arising from ancestral property is taxable as his individual income.

**Case Laws:**

The following judicial pronouncements are also valid in the context of assessment of HUFs:

(i) *CIT v. Smt. Shantaben Natwarlal Gandhi* (1989) 42 Taxman 74/177 ITR 5 (Bom.): Where the deceased was partner in a firm in his individual capacity and on his death, his sons became partners, their share of profits from firm was held as not constituting HUF's income but their individual income.

(ii) *S.R. Kalani (HUF) v. CIT* (1989) 44 Taxman 269/180 ITR 141 (MP): Where gifts to minors were genuine, income from investments out of such gifts was not assessable in hands of assessee - HUF out of whose property gifts had been made.

(iii) *CIT v. Shri Kesho Ram (HUF)* (1989) 178 ITR 572 (All.): Where Tribunal records a finding that there has been a partial partition of assessee - HUF, income of partitioned groups is not includible in assessee's income.

**7.2.2 Partition of a Hindu undivided family (Section 171)**

'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of
property does not amount to partition. Where, however, the property is not capable of physical division, partition implies such division as the property may admit.

**Who is entitled to share on partition**

Though only coparceners can demand partition, once the partition takes effect, the following persons are entitled to a share:

(a) all coparceners;
(b) a son in the womb of his mother at the time of partition;
(c) mother, who gets an equal share if the partition takes place among her sons after the death of her husband; and
(d) wife, who gets a share equal to that of a son at the time of a partition between father and sons.

**Assessment after partition (Section 171)**

A joint family, once assessed as a HUF, continues to be assessed as such till one or more coparceners claim partition. Such claim must be made by the coparceners before the assessment of the income of the HUF for the relevant assessment year is completed. On the receipt of such a claim, the Assessing Officer must make an inquiry after giving due notice to the members and record a finding whether there has been a partition and, if so, the date of the partition. The income of the family from the first day of the previous year to the date of partition is assessed as income of the HUF and from the next date of the partition to the date of close of the previous year, as the individual income of the recipient-members. If the recipient member forms another HUF along with his wife and son(s), the income of the property which was subject to partition is chargeable to tax in the hands of the new H.U.F.

**A partition of the HUF can be both total and partial**

Where the entire joint family property is divided among all coparceners and the family ceases to exist as an undivided family, the partition is total. A partial partition may be as regards: (a) the persons constituting the joint family, or (b) the properties belonging to the joint family, or (c) both. The device of partial partition has been used as a medium for reduction of proper tax liability. To curb such a practice, the Finance (No. 2) Act, 1980 inserted Sub-section 9 in Section 171 which lays down that partial partitions of HUFs effected after 31st Dec., 1978 will not be recognised for tax purposes.

**The provisions made by Sub-section (9) in Section 171 are as follows:**

(i) In a case where a partial partition of a HUF has taken place after 31.12.1978, no claim of such partition will be enquired into and the Assessing Officer will not record a finding as to whether there has been a partition of the family property. Further, any finding regarding partial partition recorded under Section 171(3) will be null and void and of no legal effect.

(ii) Such family will continue to be assessed as if no such partial partition has taken place, i.e., the property or source of income will be deemed to continue to belong to the Hindu undivided family and no member will be deemed to have separated from the family.

(iii) Each member or group of members of such family will be jointly and severally liable for any tax, interest, penalty, fine or other sum payable under the Act
by the family, whether before or after such partition. The several liability of any member or group of members of such family will be computed according to the portion of the joint family property allotted to him on such partial partition. This amendment has come into force with effect from April 1, 1980 and has, accordingly, been applicable with effect from assessment year 1980-81 and onwards.

Test Your Knowledge

1. According to Hindu law, a Joint Hindu family may consist of _______.
   (a) Persons lineally descended from a common ancestor
   (b) Married daughters of a deceased person
   (c) Persons separated from the family by partitioning of assets
   (d) Widows of the members of the family

Correct answer: (a), (d)

2. Which member of the family can demand partition in the property?
   (a) All coparceners
   (b) Son
   (c) Mother
   (d) Wife

Correct answer: (a)

7.3 TAXATION OF FIRMS

Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

The expression “partner” also includes a minor who has been admitted to the benefits of partnership and a partner of a limited liability partnership Act 2008. However a minor cannot validly enter into any partnership as a ‘full partner’ with other persons but he can be admitted to the benefits of partnership only.

A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

A partnership firm as such is not entitled to enter into a partnership with another firm, H.U.F., individual, or a company. However, its partners in their individual capacity can enter into another partnership.
(1) Scheme of taxation of a firm and its partners

Assessment as a Firm (Section 184)

As per the scheme, a partnership firm shall be assessed as a firm if the following conditions are satisfied:

1. The partnership is evidenced by an instrument i.e. partnership deed.
2. The individual shares of the partners are specified in that instrument.
3. A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.

Where the return is made after the dissolution of the firm, the copy of the partnership deed should be certified in writing by all persons (excluding minors) who were partners of the firm immediately before its dissolution and by the legal representative of any deceased partner.

When a firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or in the shares of partners as evidenced by the partnership deed on the basis of which assessment as a firm was first sought.

Where any such change has taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year. In doing so all the provisions of Section 184 will apply to the firm.

However, where in respect of any assessment year there is on the part of a firm any such failure as is mentioned in Section 144 i.e. the firm

(a) fails to make the return required under Section 139(1) and has not made a return or revised return under Section 139(4) or 139(5), or

(b) fails to comply with all the terms of a notice issued under Section 142(1) or fails to comply with a direction issued under Section 142(2A), or

(c) having made a return, fails to comply with all the terms of a notice issued under Section 143(2),

the firm shall not be assessed as a firm for the said assessment year but shall be assessed as an association of persons, and all the provisions of this Act shall apply accordingly.

Test Your Knowledge

A minor cannot validly enter into any partnership as a ‘full partner’ with other persons.

(a) True
(b) False

Correct answer: (a)
Charge of tax in the case of a Firm (Section 167A)

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%

From Assessment year 2010-11 Surcharge on income tax on all firms has been removed.

Finance Act, 2009 provides for uniform limits for both professional firms and non professional firms:

<table>
<thead>
<tr>
<th>I.</th>
<th>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.</th>
</tr>
</thead>
<tbody>
<tr>
<td>II.</td>
<td>On the balance of the book-profit — 60% of the book profits.</td>
</tr>
</tbody>
</table>

(2) Change in Constitution of a Firm (Section 187)

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

For the purposes of this section there is a change in the constitution of a firm if:

(a) one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (this clause, however, shall not apply to a case where the firm is dissolved on the death of any of its partners) or

(b) where all the partners continue with a change in their respective shares or in the shares of some of them.

(3) Losses of Registered Firms (Section 75)

Carry forward and set off of losses in case of change in constitution of firm or on succession [Section 78(1)]

Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

Method of computation of amount not to be allowed to be carried forward

Step 1: In the year of change first ascertain the share of outgoing partner in the profit or loss of the firm.
Step 2: Compute share of loss of the outgoing partner for each of the preceding years from which the loss is carried forward.

Step 3: Amount not allowed to be carried forward:

(i) Sum of [Amounts computed in Steps (1) and (2) where there is loss in the year of change].

(ii) Difference of [Amounts computed in Steps (1) and (2) in case of profit in the year of change].

(4) Assessment of Partners

As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.

Further, the explanation to Sub-clause (2A) provides that the share of a partner in the total income of the firm assessed as a firm shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm (in accordance with the partnership deed) bears to such profits.

In terms of a formula, the amount exempt would be:

\[
\text{Partners share in the profit of the firm} = \frac{\text{as shown in the partnership deed}}{\text{Total Profits of the Firm}} \times \text{Total income of the firm}
\]

Any interest, salary, bonus, commission or remuneration by whatever name called which is due to or received by a partner of a firm from the firm will be chargeable to tax in the hands of the partner under the head “profits and gains of business or profession”. However, if such salary, interest, bonus, commission or remuneration (or any part thereof) has not been allowed as deduction as per Section 40(b) in the hands of the firm, the amount not allowed as deduction shall not be charged to tax in the hands of partners.

Further, deductions under Sections 32 to 37 can be claimed by a partner from any income where any expenditure was incurred to earn such income.

(5) Succession of one firm by another firm (Section 188)

When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm’s business or carry on a similar business with or without new partners, it would be a case of succession by a new firm (62 I.T.R. 75).
In *CIT v. K.H. Chambers* (1965) 55 *ITR* 674, the Supreme Court laid down the following requisites of succession:

(i) There is a change of ownership.

(ii) The whole business is transferred.

(iii) Substantially the identity and the continuity of the business are preserved.

Where the partnership deed does not provide specifically for continuance of the firm on the death of a partner, there would be no change in constitution of the firm but it would be a case of succession. *[Addl. CIT v. Thyagasundara Mudaliar* (1981) 127 *ITR* 520].

Where a firm is succeeded by another firm, separate assessments are made on the predecessor and successor firms respectively in accordance with the provisions of Section 170 which provides that the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession and the successor shall be assessed in respect of the income of the previous year after the date of succession. If the predecessor cannot be found, or the tax assessed on the predecessor cannot be recovered from him for the previous year (in which the succession took place) and the previous year immediately preceding such previous year, the unrealised tax payable by the predecessor shall be recovered from the successor.

However, the successor firm is entitled to recover from the predecessor firm any tax paid by it on behalf of the former. If any tax is due against any partner of the predecessor firm, it cannot be recovered from the successor firm.

**Joint and several liability of partners for tax payable by firm (Section 188A)**

As per this section every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of Income-tax Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

**Firm Dissolved or Business Discontinued (Section 189)**

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provisions relating to penalty or any other sum (interest, fine) chargeable under the Act, shall apply. Consequently, every person who was a partner of the firm at the time of discontinuance of business or dissolution of the firm and legal representative of the deceased partner shall be jointly and severally liable to the amount of tax penalty and any other sum. Where the dissolution or discontinuance of business takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the partners or legal representative of a deceased partner from the stage at which the proceedings stood at the time of such dissolution or discontinuance.
Thus, every partner of the firm and the legal representative of the deceased partner is liable to pay the tax which is already due or may have become due after the dissolution, irrespective of his interest in the firm. However, if there was any irrecoverable amount at the time of dissolution or discontinuance of business and later on it was recovered by the partners, the partners shall personally pay the tax on their share so recovered.

(6) Special provisions relating to Retail Trade [Merged with Section 44AD from AY 11-12]

In the case of an assessee engaged in retail trade in any goods or merchandise, in terms of Section 44AD, 8% of his total turnover in the previous year on account of such business shall be deemed to be his business so long as his turnover from such business does not exceed ₹ 60 lacs for the corresponding period. Deductions under Sections 30 to 38 shall be deemed to have been granted and written down value of depreciable assets calculated accordingly.

However, with effect from the assessment year 1998-99 the above provisions have been amended to provide an enabling clause for an assessee to claim his income to be lower than the deemed profits and gains, subject to the condition that the books of account and other documents are kept and maintained as required under Section 44AA and the assessee gets his accounts audited irrespective of turnover and furnishes a report of such audit as prescribed under Section 44AB.

(7) Alternate Minimum Tax (AMT) (Section 115JC)

From the assessment year 2012-13 onwards, where the regular income tax payable for a previous year by a limited liability partnership 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 the LLP for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%.

Adjusted total income shall be the total income as increased by deductions claimed, if any, under section 80H to 80RRB and deduction claimed, if any, under section 10AA.

Tax credit is the excess of alternate minimum tax paid over the regular income tax payable of that year. The tax credit is allowed to be set off in any of the assessment year to the extent of excess regular income tax payable over the alternate minimum tax payable and the balance if any shall be carried forward.

The amount of tax credit shall be carried forward and set off for Ten assessment years succeeding the assessment year for which tax credit becomes allowable.

Every limit liability partnership to which this section applies shall obtain a report, in such form as may be prescribed from an accountant certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under sub-section (1) of section 139.

(8) Illustrations

Illustration:

A, B and C are the partners for 3:2:1 share respectively, in a firm engaged in
medical profession. Compute the total income of the firm for the year ended 31st March, 2012:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Expenses</td>
<td>15,400</td>
<td>Gross Profit</td>
<td>40,000</td>
</tr>
<tr>
<td>Income Tax</td>
<td>1,000</td>
<td>Net Loss A</td>
<td>8,700</td>
</tr>
<tr>
<td>Salary to A</td>
<td>5,000</td>
<td>Net Loss B</td>
<td>5,800</td>
</tr>
<tr>
<td>Salary to B</td>
<td>4,000</td>
<td>Net Loss C</td>
<td>2,900</td>
</tr>
<tr>
<td>Salary to C</td>
<td>10,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonus to A</td>
<td>10,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonus to C</td>
<td>12,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>57,400</td>
<td></td>
<td>57,400</td>
</tr>
</tbody>
</table>

**Solution:**

**Computation of Book Profit of the Firm**

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Loss as per P &amp; L A/c</td>
<td>(17,400)</td>
</tr>
<tr>
<td>Add: Inadmissible Expenses:</td>
<td></td>
</tr>
<tr>
<td>Income-tax</td>
<td>1,000</td>
</tr>
<tr>
<td>Salary to partners:</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>5,000</td>
</tr>
<tr>
<td>B</td>
<td>4,000</td>
</tr>
<tr>
<td>C</td>
<td>10,000 19,000</td>
</tr>
<tr>
<td>Bonus to partners</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>10,000</td>
</tr>
<tr>
<td>C</td>
<td>12,000 22,000 42,000</td>
</tr>
<tr>
<td>Book Profit</td>
<td>24,600</td>
</tr>
</tbody>
</table>

**Permissible remuneration to partners:**

90% of first ₹ 3,00,000 of Book-profit or ₹1,50,000 whichever is more, is allowed as deduction. Here the permissible remuneration comes to ₹ 1,50,000, but as the partners have claimed ₹ 41,000 only, hence the entire amount will be allowed.

**Computation of total income of the firm**

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book Profit</td>
<td>24,600</td>
</tr>
<tr>
<td>Less: Salary to Partners</td>
<td>19,000</td>
</tr>
<tr>
<td>Bonus to Partners</td>
<td>22,000 41,000</td>
</tr>
<tr>
<td>Loss of the firm</td>
<td>(16,400)</td>
</tr>
</tbody>
</table>

**Note:** Loss of the firm will be carried forward by the firm to the next year(s).

**Illustration:**

M, N and O are partners sharing profits and losses in the ratio of 2:1:1 respectively. Their summarised Profit and Loss A/c for the year ending 31st March, 2012 is appended below:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office salaries</td>
<td>5,680</td>
<td>Gross Profit</td>
<td>60,570</td>
</tr>
<tr>
<td>Telephone and Telegram</td>
<td>2,000</td>
<td>Rent received</td>
<td>6,000</td>
</tr>
</tbody>
</table>
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  15,000
Collection charges of
  interest on securities  50
Bad debts reserve  1,000
Net Profit to partners:
  M  20,420
  N  10,210
  O  10,210  40,840

Compute total income of the firm for the assessment year 2012-13 and tax liability thereon. Interest paid to M has been calculated at the rate of 20% p.a. simple.

Solution:

**Computation of Book-Profit**

<table>
<thead>
<tr>
<th>Item</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income as per P &amp; L A/c</td>
<td>40,840</td>
</tr>
<tr>
<td><strong>Add:</strong> Inadmissible items</td>
<td></td>
</tr>
<tr>
<td>Local taxes (on let out property)</td>
<td>1,000</td>
</tr>
<tr>
<td>Salary to N (Partner)</td>
<td>3,000</td>
</tr>
<tr>
<td>Commission to partners</td>
<td>15,000</td>
</tr>
<tr>
<td>Collection charges</td>
<td>50</td>
</tr>
<tr>
<td>Bad debts reserve</td>
<td>1,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Item</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Less:</strong> Other Incomes</td>
<td></td>
</tr>
<tr>
<td>Rent received</td>
<td>6,000</td>
</tr>
<tr>
<td>Interest on securities</td>
<td>4,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Item</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book Profit</td>
<td>50,890</td>
</tr>
</tbody>
</table>

**Maximum remuneration payable to partners**

Here ₹1,50,000 will be allowed as maximum remuneration. But as the partners have drawn only ₹ 18,000 by way of salary and commission, the entire amount will be allowed as deduction.

**Computation of total income of the firm for the assessment year 2012-13**

<table>
<thead>
<tr>
<th>Item</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book Profit</td>
<td>50,890</td>
</tr>
<tr>
<td><strong>Less:</strong> Salary and commission to partners</td>
<td>(18,000)</td>
</tr>
<tr>
<td>- Taxable Business Profit</td>
<td>32,890</td>
</tr>
<tr>
<td>- Income from house property</td>
<td></td>
</tr>
</tbody>
</table>
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)
3,500 ...(B)

- Income from other sources:
  Interest on Securities 4,000
Less: Collection charges (50) 3,950 ...(C)

GROSS TOTAL INCOME (A) + (B) + (C)
= ₹ 32,890 + 3,500 + 3,950
= ₹ 40,340

The firm will have to pay tax on ₹ 40,340 @ 30%, which comes to ₹ 12,102 plus education cess @ 3% on 12,102 making the total liability as ₹ 12,465.

Test Your Knowledge

As per Section 10(2A) of the Act, for any person who is a partner of a firm which is assessed as such, his/her share in the total income of the firm will be included in computing his/her total income.

(a) True
(b) False

Correct answer: (b)

7.4 TAXATION OF ASSOCIATION OF PERSONS

(1) Meaning

‘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 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.

(2) Formation of an Association of Persons

For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed [Shanmugham & Co. v. CIT (1971) 81 ITR 310 (S.C.)].

Applying the ratio laid down by the Supreme Court in the case of N.V. Shanmugham & Co. v. Commissioner of Income-tax (1971, 81 ITR 310) the Calcutta High Court held in the case of Gopal Chand Sen v. Income-tax Officer and others (1977, 109 ITR 820) that an assessment of business income has to be done in the hands of receivers and in such an assessment, the receivers are never assessed as independent earners of income. The income in the hands of the receiver is assessable in the like manner and to the same extent as it would have been assessed on the real owners.

Case Laws:

In the following cases AOP was found to exist:

(1) **CIT v. Chhotalal Mohanlal** (1940) 8 ITR 114: Members of erstwhile HUF earning income jointly even after partition of HUF.

(2) **Viswanatha Chettiar v. Ag. ITO** (1965) 55 ITR 692: Co-heirs, co-legatees or co-donees, joining together in a common purpose or action would be chargeable as association of persons. Hence, in a case where on transfer of the right to ownership by the father to his three sons, without specifically dividing the corpus, the sons worked the estate jointly and earned profits, they were assessed as an “Association of Persons”.

(3) **Shanmugham & Co. v. CIT** (1971) 81, ITR, 310 (S.C.): The circumstance that the association emerges as a result of an order of the Court appointing a receiver is immaterial. Thus, where receivers were appointed in a suit for dissolution of a firm, to reopen and carry on the business till winding up, the firm was held to be assessable as AOP.

(4) **Ganga Metal Refining Co. Pvt. Ltd. v. CIT** (1968, 67 ITR 771): Company joining with two other companies in joint venture.

However, co-owners, co-heirs or co-legatees do not constitute an AOP in respect of the income of the joint or common asset by reason only of their jural relationship. But if they write themselves with the objective of earning income they constitute an AOP for assessment purposes. [Estate of Mohamed Rowther v. CIT (1963, 49 ITR 39)]. Section 26 of the Income-tax Act provides that where property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons in definite and ascertainable shares, such persons shall not, in respect of such property be assessed as an AOP, but on their respective share of income therefrom.

In order to constitute an association of persons, there must be joining together in a common purpose or in a common action, the object of which is to
produce income, profits and gains. Though a body of individuals is not identical with an association of persons, they have some similarities. An association of persons may consist of non-individuals also but a body of individuals has to consist only of human beings. The word 'body' would require an association for some common purpose or for a common cause or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common 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)].

Test Your Knowledge

‗Association of Persons‘ means an association in which two or more persons join in a charitable trust for the well-being of society.

(a) True
(b) False

Correct answer: (b)

(3) Tax Liability of an Association of Persons

With effect from assessment year 1989-90, the following provisions are applicable to assessees other than companies, co-operative societies and societies registered under the Societies Registration Act, 1860 or any law corresponding to that Act in force in any part of India.

(1) Interest paid by the AOP to a member will not be allowed as a deduction from the income of the Association of Persons [Section 40(ba)].

In cases where interest is paid by the AOP to any member, who has also paid interest to the AOP, the net amount of interest that will be disallowed is the amount of interest paid by the AOP to the member less the amount of interest paid to the AOP by the member [Explanation 1 to Section 40(ba)].

(2) In cases where an individual is a member of an AOP in a representative capacity, any interest paid by the AOP to such individual or by such individual to the AOP, otherwise than in a representative capacity will not be subject to disallowance under explanation 2(i) to Section 40(ba).

(3) In the cases of interest paid by AOP to such individual or by such individual to the AOP in a representative capacity any interest paid by the AOP to the person represented by such person or vice versa, will not be allowed under Section 40(ba) [Explanation 2(ii) to Section 40(ba)].

(4) Explanation 3 to Section 40(ba) further provides that where an individual is a member of the AOP otherwise than as member in a representative capacity, any interest paid by the AOP to such individual will not be disallowed if the interest is received by him on behalf of any other person.

(5) Any salary, bonus, commission or remuneration (by whatever name called) paid by the AOP to a member will not be allowed as a deduction.

Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.
A. Where shares of members are determinate

In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate, i.e. the highest slab applicable to an individual. (30%)

More so, where the total income of any member of the AOP, irrespective of whether or not it exceeds the maximum amount not chargeable to tax in the case of an individual, is chargeable to tax at a rate higher than the maximum marginal rate, tax will be charged on the total income of the AOP at such higher rate.

B. Where the shares of the members are indeterminate

In these cases, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year.

The individual shares of the members in the whole or any part of the income of the AOP will be deemed to be indeterminate or unknown if such shares are indeterminate or unknown on the date of formation of the AOP, or at any time thereafter.

(4) Method of Computing Share of a Member of Association of Persons, etc. (Section 67A)

Section 67A seeks to provide for the method of computing a member’s share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner’s share in a firm.

This section lays down the following methods of computing the member’s share:

(a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.

(b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount - the result shall constitute the member’s share in the income of the association or body.

(c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the
result shall be treated as the member’s share in the income of the association or body.

See also explanatory notes on the provision of DTL (Amendment) Act, 1987 Board circular No. 551 dated 23.1.1990 [(1990, 183 ITR 1 (SC)].

**Tax on Income of association of persons, etc. which is indeterminate or unknown (New Section 167B)**

Section 167B seeks to provide that where the individual shares of the members of an association or body in the whole or any part of the income of such association or body are indeterminate or unknown, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where the total income of any member of such association or body is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on the total income of the association or body at such higher rate. Also, where the total income of any member of an association of persons or body of individuals as above for the previous year (excluding his share from such association or body) exceeds the maximum amount which is not chargeable to tax in the case of that member, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where any member or members of such association or body of individuals is or are chargeable to tax for the previous year at a rate or rates which is or are higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the association or body of individuals which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income the association or body shall be taxed at the maximum marginal rate.

In the explanation to the above provisions, it is provided that the shares of the members of an association or body in the whole or any part of the income of such association or body shall be deemed to be indeterminate or unknown if such shares (in relation to the whole or any part of such income) are indeterminate or unknown on the date of formation of such association or body or any time thereafter.

**Share of a member of association etc. (Section 86)**

Section 86 relates to shares of members of an association of persons or a body of individuals in the income of the association or body. This section provides that if the assessee is a member of an association of persons or a body of individuals (other than a company or a Co-operative society or a Society registered under the Societies Registration Act, 1860, or any law corresponding to that Act in force in any part of India), his share in the income of the association or body, computed in the manner provided in Section 67A shall not be liable to tax.

Further, where the association or body is chargeable to tax on its total income at the maximum marginal rate or any higher rate, under any of the provisions of the Income-tax Act, his share computed in the manner stated above shall not be included in his total income.

But, in other cases and in cases where no income-tax is chargeable on the total income of the association or body, the member’s share shall be chargeable to tax as part of his total income and Section 86 shall not be applicable to such case.
The charge of tax on the member's share in AOP will depend on the following factors:

(i) Income-tax is not payable by the member in respect of his share in the income of the AOP, computed in the manner provided in Section 67A.

(ii) His share in the income of the AOP is includible in his total income for rate purposes.

(iii) Where the AOP is chargeable to tax on its total income at the 'maximum marginal rate' or at any higher rate, the share of the member will not be includible in his total income. In this case, the member's share in the income of the AOP will not be included in his income even for rate purposes.

(iv) In any other case, the member's share will form part of his total income.

(v) Where no income-tax is chargeable on the total income of the AOP, the share of the member will be chargeable to tax part of his total income. Section 86 will not be applicable to such cases.

(5) 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.

Test Your Knowledge

Every person who was at the time of a discontinuance or dissolution of a AOP shall jointly and severally be liable for the amount of tax, penalty or other sum payable.

(a) True

(b) False

Correct answer: (a)

7.5 TAXATION OF CO-OPERATIVE SOCIETIES

(1) Meaning [Section 2(10)]

'Co-operative Society' means a co-operative society registered under the Co-
operative Societies Act, 1912, or under any other law for the time being in force in any State for the registration of co-operative societies.

A regional rural bank (to which provisions of the Regional Rural Bank Act, 1976, apply) is deemed to be a co-operative society [Circular No. 319 dated 11.1.1982].

(2) Computation of Income of Co-operative Societies

The income of a co-operative society is computed in the same manner as provided for other assesses. Further, the subsidy given by the government to a co-operative society for meeting managerial expenses and admission fee collected by the society is treated as revenue receipt and liable to tax. [Ludhiana Central Co-operative Consumers’ Stores Ltd. v. C.I.T. (1980) 122, I.T.R. 942].

There is, however difference of opinion with regard to tax treatment of ‘subsidy’ received from the Government. Distinguishing the ratio laid down by the Punjab & Haryana High Court in the case of Ludhiana Central Co-operative Consumers’ Stores Ltd. v. Commissioner of Income-tax (1980, 122 ITR 942), the Punjab & Haryana High Court held in the case of Commissioner of Income-tax v. Jindal Brothers Rice Mills (1989, 179 ITR 470) that depreciation is allowable on the cost of the machinery or plant reduced by the amount of the subsidy as actual cost stands reduced by the percentage allowed by the subsidy. Though this case was followed by it in the case of Commissioner of Income-tax v. Janak Steel Tubes (Pvt.) Ltd. (1989, 179 ITR 536) (the capital subsidy should be deducted from the value of plant and machinery) but had been dissented from by the Bombay, Madras and Rajasthan High Courts in the following cases:

(i) Srinivas Industries v. Commissioner of Income-tax (1991, 188 ITR 22): The Madras High Court held that the subsidy really partook the character of cash grant expendable for any purpose-consequently, the amount of subsidy granted could not be deducted from the capital cost of the machinery.

(ii) In Commissioner of Income-tax v. Elys Plastics Pvt. Ltd. (1991, 188 ITR 11) the Bombay High Court held that the subsidies were not deductible in computing the cost of plant and machinery for purposes of allowing depreciation.

(iii) In Commissioner of Income-tax v. Ambica Electrolytic Capacitors (P) Ltd. and others (1991, 191 ITR 494) the Rajasthan High Court held that the subsidy or investment subsidy given by the Government cannot be deducted from the actual cost for purposes of investment or depreciation allowance.

A co-operative society is entitled to the deductions from its gross total income under Sections 80G, 80GGA, 80GGC, 80-IA, 80-IB, 80JJA and 80P.

Deduction in respect of income of co-operative societies (Section 80P)

Section 80P provides for certain deductions from the gross total income of a Co-operative Society. These deductions are:

(a) In the case of Co-operative Society engaged in:

(i) the business of Banking or providing credit facilities to its members, or
(ii) a cottage industry, or

(iii) the marketing of the agricultural produce grown by its members, or

(iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for purpose of supplying them to its members, or

(v) the processing, without the aid of power, of the agricultural produce of its members, or

(vi) the collective disposal of the labour of its members, or

(vii) fishing or allied activities, i.e., catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members,

the whole of the amount of profits and gains of business attributable to any one or more of such activities shall be deducted from the gross total income provided that in the case of a co-operative society falling under Sub-clause (vi) or (vii), the rules and bye-laws of the society restrict the voting rights to the following classes of its members:

(i) the individuals who contribute their labour or carry on the fishing or allied activities;

(ii) the co-operative credit societies which provide financial assistance to the society;

(iii) the State Government.

(b) In the case of primary co-operative society engaged in supplying milk, oilseeds, fruits, vegetables raised or grown by its members to

(i) a federal co-operative society engaged in supplying the above mentioned products; or

(ii) a Government or a local authority; or

(iii) a Government Company or a Corporation established by or under a Central, State or a Provincial Act (being a company or corporation engaged in supplying the above mentioned products to the public).

the whole of the amount of profits and gains of such business shall be deducted from the gross total income.

In the case of a co-operative society engaged in activities other than those specified in clauses (a) or (b) either independently of, or in addition to, profits and gains attributable to the activities mentioned at clauses (a) and (b) deduction from the gross total income will be allowed to the extent of ₹ 50,000 w.e.f. assessment year 1999-2000.

(c) Where such co-operative society is a Consumers’ Co-operative Society, the deduction shall be ₹ 1,00,000 w.e.f. assessment year 1999-2000.

(d) In the case of every co-operative society, the whole of the income by way of interest or dividends derived from its investments with any other co-operative society shall be deducted from the gross total income.
(e) In the case of every co-operative society, the whole of the income derived by the society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities shall be deducted from its gross total income.

(f) In the case of every co-operative society, not being a housing society or an urban consumers’ society, or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power, where the gross total income does not exceed ₹ 20,000 the amount of any income by way of interest on securities or any income from house property shall be deducted from the gross total income.

**Urban Consumers’ Co-operative Society**

An urban consumers’ co-operative society means a society for the benefit of consumers, within the limits of a municipal corporation, municipality, notified areas committee, town area or, cantonment [Explanation to Section 80P(2)].

The provisions of this Section shall not apply in relation to any cooperative bank other than a primary agricultural credit society or a primary cooperative agricultural and rural development bank.

(3) **Assessment of Co-operative Societies**

The following are the provisions which are specifically applicable to the assessment of Co-operative Societies:

I. **Co-operative Housing Society.** Under Section 27(iii), a member of co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, shall be deemed to be owner of that building or part thereof.

Clause (iiia) further provides that a person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 shall be deemed to be the owner of that building or part thereof; and

As per Clause (iiib), a person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of any such transaction as is referred to in Clause (f) of Section 269UA, shall be deemed to be the owner of that building or part thereof.

Clause (f) of Section 269UA, it may be noted, defines “transfer” for the purposes of Chapter XX-C of the Income-tax Act, dealing with purchase by Central Government of immovable properties in certain cases of transfer.

II. **Profits and Gains of Co-operative Society from insurance business (Section 44).** The profits and gains of any business of insurance carried on by a Co-operative Society shall be computed in accordance with the rules contained in the First Schedule.

In this connection, the First Schedule and Rule 6E of the Income-tax Rules, 1962 provides as under:
The profits of non-life insurance business, e.g., Fire insurance business, marine insurance business, general insurance business etc. shall be the profits disclosed by the annual accounts required to be prepared under the Insurance Act, 1938 subject to the following adjustments:

(i) If such profits are arrived at after deducting any expenditure or allowance which is not admissible under Sections 30 to 43B of the Income-tax Act, such expenditure or allowance shall be added back to the profits.

(ii) The reserve for unexpired risks shall be allowed as a deduction to the following extent:

(a) where the insurance business relates to fire insurance or miscellaneous insurance - 50% of the net premium income of such business of the previous year;

(b) where the insurance business relates to marine insurance, 100% of the net premium income of such business of the previous year.

'Net premium income' means the amount of premium received, as reduced by the amount of re-insurance premiums paid during the relevant previous year.

In the context of computing the total income of co-operative society, the following cases are worth noting.

(1) Where the credit facility is extended to members of the society by virtue of sale of goods to them by consumers' co-operative society, the exemption is not available. When the society sells goods on credit to its members, such transaction cannot be construed as a credit society to which the benefit of Section 80P(2)(a)(i) can be extended. [Rodier Mill Employees’ Co-operative Stores Ltd. v. 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.

(2) Where society purchases auto-rickshaws and sells them to members on hire-purchase, it is not providing credit facility to members and not entitled to exemption [C.I.T. v. Madras Auto Rickshaw Drivers’ Co-operative Society (1983) 143 ITR 981]. In this case it was held that the tax relief under Section 80P(2)(a)(i) of the Income-tax Act, is a grant not to a category of income but to a category of assesses namely, a co-operative society answering the description of a society engaged in carrying on the business of providing credit facilities to its members. If the society in question does not answer to this description, it is not entitled to the relief.

(3) In Bihar State Co-operative Bank Ltd. v. C.I.T. [(1960) 39 I.T.R. 114] the Supreme Court has held that if a co-operative society carrying on banking business
invests its circulating capital in such a manner that it is readily available, the interest on such investment shall constitute income from banking business and therefore shall be exempt in the hands of the co-operative society.

(4) Interest received on Government Securities held by co-operative society as its stock-in-trade qualifies for deduction from gross total income. But the deduction is inapplicable to interest received from Government Securities held as investments. [CIT v. Bombay State Co-operative Bank Ltd. (1968) 70 ITR 86 (S.C.).]

The Madhya Pradesh High Court held in the case of M.P. State Co-operative Bank Ltd. v. Addl. Commissioner of Income-tax (1979, 119 ITR 327) that income from investment of reserve capital in securities was not a part of the income from banking business and did not qualify for exemption. Similarly, the interest income from investment of provident fund income did not form part of the income from the banking business and did not qualify for exemption under Section 80(i)(a) (now Section 80P). Distinguishing the ratio laid down in this case, the Madhya Pradesh High Court held in the case of Commissioner of Income-tax v. Bhopal Co-operative Central Bank Ltd. (1987, 164 ITR 713) that the security deposits made are in accordance with the Banking Regulation Act, 1949 and interest income received on deposits formed part of income from business of banking and exempt under Section 80P(2)(i) of the Income-tax Act, 1961.

The Allahabad High Court held in the case of Addl. Commissioner of Income-tax v. U.P. Co-operative Cane Union (1978, 114 ITR 70) that selling goods on credit was only a mode of carrying on business. It did not become a business of providing credit facility. Following this case, the Allahabad High Court held in the case of Commissioner of Income-tax v. U.P. Co-operative Cane Union Federation Ltd. (1980, 122 ITR 913) that the expression ‘providing credit facilities’ in Section 80P(2)(a)(i) would comprehend the business of lending money on interest. It would also comprehend the business of lending services on profit for guaranteeing payments because guaranteeing payment is as much a part of banking business for affording credit facility as advancing loans.

However, where a co-operative society holds securities as per requirements of Banking Regulation Act and directions of the RBI, the deduction is available on such interest income. Similarly, subsidy from Government for opening new branches and giving loans to poorer sections at lower rate of interest, is income attributable to banking business [CIT v. Madurai District Central Co-operative Bank Ltd. (1984) 148 ITR 196].

(5) The Income earned by a co-operative society carrying on the business of banking and providing credit facilities to its members from commission and brokerage by dealing in bills of exchange, subsidy from Government, admission fee from members, incidental charges and financial penalties is attributable to the business of banking of providing credit facilities to its members and hence deductible under Section 80P(2)(a)(i) [CIT v. Dhar Central Co-operative Bank (1984) 149 ITR 438 (MP)].

Following its decision in the case of Commissioner of Income-tax v. Dhar Central Co-operative Bank (1984, 149 ITR 438), the Madhya Pradesh High Court held in the case of Commissioner of Income-tax v. Bhopal Co-operative Central Bank Ltd. (1988, 172 ITR 423) that a co-operative society carrying on the business of banking
is entitled to exemption in respect of interest on securities, commission, subsidy, donation and locker rent. Again, the said decision was followed by it in the case of Madhya Pradesh Rajya Sahakari Bank v. Commissioner of Income-tax (1988, 174 ITR 150) holding that the income from commission, exchange and other miscellaneous income was attributable to the business of banking and that the assessee was entitled to exemption under Section 81 (now 80P) of the Income-tax Act, 1961 in respect thereof.

(6) A society which buys and sells products of other societies or individuals is not entitled to exemption. Where a society manufactures and sells its own products or the products of its members, such society is entitled to exemption. Hence, the Central Cottage Industries Emporium, New Delhi, is not entitled to exemption under Section 80P [Addl. C.I.T. v. Indian Co-operative Union Ltd. (1982) 134 ITR 108 (Delhi)].

If the godown or warehouse is let for a purpose other than storage, processing of facilitating the marketing of commodities, the income derived therefrom by a co-operative society would not be deductible under Section 80P C.I.T. v. Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd. [(1986) 162 ITR 142 (Guj.)] it was also held in this case that shops in which wholesale or retail business in cloth is carried on cannot come within the meaning of ‘godowns’ or ‘warehouses’.

The Gujarat High Court’s decision in the case of Commissioner of Income-tax v. Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd. (1986, 162 ITR 142) had since been approved by the Supreme Court in the case of South Arcot District Co-operative Marketing Society Ltd. (infra). The Gujarat High Court had, inter alia, held that the words facilitating the marketing of commodities’ would not lend colour to the words ‘godowns or warehouses’ so as to enlarge their meaning.

Test Your Knowledge

The subsidy given by the government to a co-operative society for meeting managerial expenses and admission fee collected by the society is liable to tax.

(a) True
(b) False

Income of co-operative societies (Section 80P)

Amount received for letting of godowns, incidental services of taking delivery of stock at rail-head and transporting it to godowns were also rendered and amount received was described as ‘commission’ was wholly exemption C.I.T. v. South Arcot District Co-operative Marketing Society Ltd. (1989) 43 Taxman 328/176 ITR 117 (SC).


Where assessee, an apex co-operative society, derived (i) interest on cash security furnished by it for carrying on sugar agency business, and (ii) interest on temporary loans given by it for financing sugar business, while former interest was
not exempt, latter was exempt under Section 14(3)(iii) of the 1922 Act, CIT v. U.P. Co-operative Federation Ltd. (1989) 176 ITR 435/43 Taxman 20 (SC).

Amount of subsidy received by assessee from National Co-operative Development Corpn. towards loss incurred on account of price fluctuation qualifies for deduction under Section 81(1)(c) - CIT v. Punjab State Co-operative Supply & Marketing Federation Ltd. (1989) 46 Taxman 156 (Punj. & Har.).

Proportionate expenditure relating to such business activities of assessee co-operative society as are contemplated by Section 80P(2) is not to be disallowed. Baghapurana Co-operative Marketing Society Ltd. v. CIT (1989) 178 ITR, 653/44 Taxman 92 (Punj. & Har.).

In the cases of agricultural produce, the agricultural produce marketed by assessee co-operative society need not have been produced by assessee’s members - CIT v. Punjab State Co-operative Supply & Marketing Federation Ltd. (1989) 46 Taxman 156 (Punj. & Har.).

The expression ‘the marketing of the agricultural produce of its members means that agricultural produce should be owned by its members, whether supplied by them (that is, the members) or purchased from the market or acquired from any other producer. C.I.T. v. Haryana State Co-operative Supply & Marketing Federation Ltd. (1989) 79 CTR (Punj. & Har.) 94.

Short-term call deposits are investment within the meaning of Section 80P(2)(d) CIT v. Haryana Co-operative Sugar Mills Ltd. (1989) 46 Taxman 28 (Punj. & Har.).

(4) Rates of Income-tax

| The rates of income-tax applicable to a co-operative society for the assessment year 2012-13 are as follows: |
|---|---|
| 1. Where the total income does not exceed ₹ 10,000 | 10% of total income. |
| 2. Where the total income exceeds ₹ 10,000 but does not exceed ₹ 20,000 | ₹ 1,000 plus 20% of the amount by which the total income exceeds ₹ 10,000. |
| 3. Where the total income exceeds ₹ 20,000 | ₹ 3,000 plus 30% of the amount by which the total income exceeds ₹ 20,000. |

Education cess @ 3%.

*The winnings from lotteries, crossword puzzles, horse races etc. are taxable at a flat rate of 30 per cent.*

From the amount of tax so determined, the following tax adjustments shall be made:

(1) Rebate under Section 86 in respect of share of profit from an association of persons.

(2) Determination and inclusion of reasonable amount of profits deemed by the Assessing Officer, to be attributable to transactions with non-residents.
(5) Illustrations

Illustration:

Delhi Co-operative Society derived the following incomes during the previous year (1.4.2011 to 31.3.2012 – assessment year 2012-13).

<table>
<thead>
<tr>
<th>Income Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketing of agricultural produce of its members</td>
<td>10,000</td>
</tr>
<tr>
<td>Interest from members on delayed payment of the price of goods purchased</td>
<td>1,000</td>
</tr>
<tr>
<td>Processing (without aid of power) of agricultural produce of its members</td>
<td>8,000</td>
</tr>
<tr>
<td>Supplying milk to the Government (raised by its members)</td>
<td>15,000</td>
</tr>
<tr>
<td>Agency business</td>
<td>25,000</td>
</tr>
<tr>
<td>Dividends from other Co-operative Societies</td>
<td>15,000</td>
</tr>
<tr>
<td>Income from letting of godowns</td>
<td>20,000</td>
</tr>
<tr>
<td>Income from House Property</td>
<td>30,000</td>
</tr>
</tbody>
</table>

Compute the total income of the Delhi Co-operative Society.

Solution:

Computation of total income of Delhi Co-operative Society

<table>
<thead>
<tr>
<th>Income Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from House Property</td>
<td>30,000</td>
</tr>
<tr>
<td>Letting of godowns</td>
<td>20,000</td>
</tr>
<tr>
<td>Total income</td>
<td>50,000</td>
</tr>
</tbody>
</table>

(2) Income from Business:

<table>
<thead>
<tr>
<th>Income Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketing of agricultural product</td>
<td>10,000</td>
</tr>
<tr>
<td>Processing of goods</td>
<td>8,000</td>
</tr>
<tr>
<td>Supplying milk</td>
<td>15,000</td>
</tr>
<tr>
<td>Agency business</td>
<td>25,000</td>
</tr>
<tr>
<td>Total income</td>
<td>58,000</td>
</tr>
</tbody>
</table>

(3) Income from other sources:

<table>
<thead>
<tr>
<th>Income Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest from members</td>
<td>1,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>15,000</td>
</tr>
<tr>
<td>Total income</td>
<td>16,000</td>
</tr>
</tbody>
</table>

Gross Income                                                                                     | 1,24,000   |

Deductions under Section 80P:

<table>
<thead>
<tr>
<th>Deduction Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Letting of godowns</td>
<td>20,000</td>
</tr>
<tr>
<td>Marketing of agricultural produce</td>
<td>10,000</td>
</tr>
<tr>
<td>Processing of goods</td>
<td>8,000</td>
</tr>
<tr>
<td>Supplying milk</td>
<td>15,000</td>
</tr>
<tr>
<td>Agency business</td>
<td>25,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>15,000</td>
</tr>
<tr>
<td>Total deduction</td>
<td>93,000</td>
</tr>
<tr>
<td>Total income</td>
<td>31,000</td>
</tr>
</tbody>
</table>

Notes:

(1) Interest from members ₹ 1,000 is not deductible as it is not from the credit
facilities provided to the member and for this purpose society cannot be said to be a credit society [Rodier Mill Employees' Co-operative Stores Ltd. v. CIT (1982) 135 ITR 355].

(2) The gross total income of the society exceeds ₹ 20,000 hence deduction regarding income from house property is not available.

**Test Your Knowledge**

What is the rate of income-tax applicable to a co-operative society for the Assessment Year 2012-13 when total income does not exceed ₹ 10,000?

(a) 8% of the total income
(b) 9% of the total income
(c) 10% of the total income
(d) 11% of the total income

Correct answer: (c)

(6) Tonnage Tax Scheme [Sections 115V to 115VZC] (w.e.f. A.Y. 2005-06)

To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits has been introduced. Many maritime nations have introduced tonnage based taxation. Some of the basic features of the tonnage tax scheme are as follows:

— It is a scheme of presumptive taxation whereby the notional income arising from the operation of a ship is determined based on the tonnage of the ship.

— The notional income is taxed at the normal corporate rate applicable for the year. Tax is payable even if there is a loss in any year.

— A company may opt for the scheme and once such option is exercised, there is a lock in period of ten years. If a company opts out, it is debarred from re-entry for next ten years.

— Since this is a preferential regime of taxation, certain conditions like, creation of reserves, training etc. are required to be met. A company may be expelled in certain circumstances.

— The income is computed under Section 115VG in respect of tonnage capacity of ship multiplied by the slab rate.

### 7.6 TAXATION OF NON-RESIDENTS

(1) Introduction

In the early stages of development every country has to depend to some extent on foreign capital and foreign technicians for the industrial development of the country. The Government of India also has been extremely anxious to attract foreign capital and technical know-how. To attract these, certain tax concessions have been granted to foreign investors and technicians and the Government has plans to offer still more concessions in the near future. The foreign investors may be Indian
Nationals who reside outside India and other foreign investors including corporations. A person who resides outside India is technically known as “non-resident”. The residential status of an individual does not depend upon the nationality or domicile of that person but it depends upon his stay in India during the previous year. In case of an assessee, other than an individual, the residence depends upon the place from which its affairs are controlled and managed. If the control and management of the affairs of a foreign company is, during the previous year, situated wholly in India, it shall be treated as resident in India. Where part of the control and management of the affairs of a foreign company is situated outside India, it shall be treated as a non-resident company.

**Note:** For details see ‘Residence in India’ Study I.

The total income of a ‘non-resident’ includes:

(i) income received or deemed to be received in India in such year by him or on his behalf (income which is received in the first instance outside India and is subsequently remitted or otherwise transferred to India is not treated as income received in India for the purposes of taxation); and

(ii) income which accrues or arises or is deemed to accrue or arise to him in India during such year.

A non-resident is not liable to pay tax on his foreign income until and unless it is received in India. Further, remittances to India in any previous year out of earlier year’s income, i.e. income received and/or earned abroad in earlier years, are not charged to Indian Income-tax. If a person is a ‘non-resident’ for any year whether he is an Indian National or not, he is not liable to pay tax on remittances to India out of his income earned outside India during that year. If a non-resident has dealings with any person resident in India at arm’s length and on principal-to-principal basis and all operations are carried out outside India, no income will be deemed to accrue or arise to him on such dealings. Further, no income is deemed to arise to him in India if he purchases goods in India for export even if he maintains an office in India for the purpose. Section 10 of the Income-tax Act also grants exemption to certain incomes in the hands of the non-residents.

Again, in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India [Explanation to Section 9(1)(i)]. Note that if any income has been once included in the total income on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him in India, the same is not to be included again when it is received by him in India.

**Note:** For details regarding “income received”, “income deemed to be received” and “income deemed to accrue or arise in India” see - “Meaning and scope of total income” - Study III.

**(2) Exemptions and Concessions to Non-residents**

The Act has provided a large number of concessions to foreigners on their income earned in India. These have already been discussed in Study 2, but a few of
them are given below for the convenience of students.

1. Interest income as follows, is wholly exempt [Section 10(4)] including income by way of premium on redemption of such securities and bonds w.e.f. assessment year 1989-90.

   (a) In the case of a non-resident, any income by way of interest on such securities or bonds as the Central Government may, by notification in the Official Gazette, specify in this behalf, including income by way of premium on the redemption of such bonds;

   In the case of an individual, who is a person resident outside India as defined in clause (q) of Section 2 of the Foreign Exchange Regulation Act, 1973, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India in accordance with the said Act and the rules made thereunder.

   (b) Interest on National Savings Certificates (issued by the Central Government in the hands of non-resident Indian citizens u/s 10(4B)).

2. Leave Travel Concession: From assessment year 1989-90, the exemption in respect of value of leave travel concession and passage money presently available to citizens only, was extended to non-citizens also. It has also been provided that the exemption will be limited to the amount actually spent. The ceiling on the number of journeys for going to any place in India on leave and also on the amount of exemption per head is being provided in the rules on the lines of the ceilings in the case of Government servants.

3. Certain incomes of individuals not a citizen of India irrespective of their residential status - Section 10(6)(i) to (vi).

4. Remuneration for service on a foreign ship - Section 10(6)(viii).

5. Remuneration of foreign Government Employees for training - Section 10(6)(xi).

6. Specially low rate of income-tax on dividends other than dividends referred to in Section 115-O, royalties, interest from securities, fees for technical services in the case of foreign companies - Section 115A.

7. Tax paid by a Government or an Indian concern to a non-resident (not being a company) or a foreign company on any income derived pursuant to an agreement entered into by the Central Government with the Government of a foreign state or an international organisation is also exempt from tax with effect from 1.4.1988. To be eligible for exemption the income should not constitute salary, royalty or fees for technical services and the tax should be payable to the Central Government under the terms of the agreement or any other related agreement approved by the Central Government.

8. Section 10(15)(iid) provides that interest received by a non-resident Indian from such bonds as are notified by the Central Government or by any individual owning the bonds by virtue of being a nominee or survivor of such non-resident Indian or by an individual to whom the bonds have been gifted by the non-resident, will not be included in computing the total income of such individual. However, the bonds should have been purchased by a non-
resident Indian in foreign exchange and the interest and principal received in respect of such bonds whether on their maturity or otherwise, is not allowable to be taken out of India. Also, even where the individual who is non-resident Indian in the previous year in which the bonds are acquired, becomes a resident in India in any subsequent year, the interest received from such bonds will continue to be exempt in the subsequent years as well.

In the case of premature encashment of the bonds, the exemption shall stand withdrawn from the year of encashment.

**Special Provisions relating to certain Incomes of Non-resident Indian**

Chapter XII-A containing 7 Sections from 115C to 115-I contains special provisions relating to certain incomes of non-resident Indian. All these sections are given below:

**Definitions (115C):**

(a) **Convertible Foreign Exchange** means foreign exchange which is, for the time being, treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Management Act, 1999 and any Rules made thereunder.

(b) **Foreign Exchange Asset** means any specified asset which the assessee has acquired, purchased with or subscribed to, in convertible foreign exchange.

(c) **Investment Income** means any income other than dividend referred to in Section 115-O derived from a foreign exchange asset.

(d) **Long-term capital gains** means income chargeable under the head “capital gains” relating to a capital asset being a foreign exchange asset which is not a short-term capital asset.

(e) **Non-resident Indian** means an individual, being a citizen of India or a person of Indian origin who is not a resident. A person shall be deemed to be of Indian origin if he or either of his parents or any of his grand parents, was born in undivided India.

(f) **Specified Asset** means any of the following assets:

   (i) shares in an Indian company;
   
   (ii) debentures issued by an Indian company which is not a private company as defined in the Companies Act, 1956;
   
   (iii) deposits with an Indian company which is not a private company;
   
   (iv) any security of the Central Government;
   
   (v) such other assets as the Central Government may specify in this behalf by notification in the Official Gazette.

**Computation of Investment Income of Non-resident (115D):** No deduction in respect of any expenditure or allowance shall be allowed under any provisions of this Act in computing the investment income of a non-resident Indian -
In case of an assessee being a non-resident Indian -

(a) if the gross total income consists only of investment income or income by way of long-term capital gains or both, no deductions shall be allowed to the assessee under chapter VI-A (Sections 80C to 80U) and nothing contained in the provisions of the second proviso to Section 48 shall apply to income chargeable under the head capital gains.

(b) if the gross total income of such an assessee includes any income referred to under clause (a) above, the gross total income shall be reduced by the amount of such income and the deductions under chapter VI-A shall be allowed as if the gross total income as so reduced were the gross total income of the assessee.

**Tax on Investment Income and Long-term Capital Gains (115E):**

- Where the total income of an assessee, being a non-resident Indian includes -
  - (a) Income from foreign exchange asset (not applicable in the case of dividends referred to in section 115-O) 20%
  - (b) Income by way of long term capital gains 10%

**Capital Gains on transfer of foreign exchange assets not to be charged in certain cases (115F):** In a case where a foreign exchange asset is transferred by the assessee and the net consideration for the transfer is invested by him within six months of the date of transfer in any specified asset or in notified savings certificates, any long-term capital gains arising from the transfer will not be charged to tax. If investment in the aforesaid specified assets or savings certificates is less than the net consideration, the exemption from tax in respect of the long-term capital gain will be allowed on proportionate basis.

It is also provided that if the new asset acquired by investing the net consideration realized on transfer of the foreign exchange asset is transferred or converted (otherwise than by transfer) into money, within three years from the date of acquisition, the amount of capital gains earlier exempted will be regarded as capital gains relating to long-term capital asset of the year in which the new asset is transferred or converted (otherwise than by transfer) into money.

'Net Consideration' in relation to the transfer of the original asset means the full value of the consideration received or accruing as a result of the transfer of such assets as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

**Return of Income not to be filed in certain cases (115G):** A non-resident Indian is not required to furnish his return of income u/s 139(1) if the following conditions are satisfied:

His total income in respect of which he is assessable under this Act during the previous year consists only of investment income or income by way of long-term capital gains or both and the tax at source has been deducted under the provisions of Chapter XVII-B.

**Benefit under this chapter to be available in certain cases even after the**
assessee becomes resident (115H): In the case of a non-resident Indian who becomes resident in India in a subsequent year, the provisions of this Chapter XII-A will continue to apply in relation to the investment income derived from debentures of and deposits with an Indian public limited company and Central Government securities acquired in convertible foreign exchange, and other notified assets until the transfer or conversion (otherwise than by transfer) into money of such asset.

Chapter not to apply if the assessee so chooses (115-I): According to this section, a non-resident Indian will have the option or choice of not being assessed under the above provisions, for any assessment year for furnishing his return of income for that assessment year under Section 139, declaring therein his intention to that effect.

Modification in the provisions of computation of capital gains from shares/debentures

The first proviso to Section 48 has been amended by the Finance Act, 1992 with effect from the assessment year 1993-94.

Now, with the amendment all non-residents (instead of NRIs) will be entitled to the protection from fluctuation of rupee value against foreign currency in respect of capital gains on shares in or debentures of Indian Companies. Thus, for all non-residents, capital gains arising from the transfer of capital asset being shares in or debentures of an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter, in, and sale of shares in, or debentures of an Indian company.

Tax on dividends, royalty and technical service fees (Section 115A)

A non-resident (other than a company) and a foreign company will pay tax on its income as under:

(i) On dividend income other than dividends referred to in Section 115-O – @ 20%

(ii) Interest received from Government or an Indian concern on money borrowed or debt incurred by Government - @ 20%

(iii) Income received in respect of units, purchased in foreign currency of a Mutual Fund specified in Section 10(23D) (i.e., a mutual fund set-up by a public sector bank or a public financial institution) or of the Unit Trust of India – @ 20%

No deduction in respect of expenditure or allowance shall be allowed to the assessee under Sections 28 to 44C, and 57 and 80C to 80U.
(iv) On any other income at the rates prescribed under the Finance Act of the relevant year.

**Tax on income from units purchased in foreign currency (Section 115AB)**

Special rates of tax are applicable to certain incomes of Overseas Financial organisation. In short, it will be called ‘Off-shore Fund’.

The income tax shall be payable at 10% of the following incomes of the Off-shore Fund:

(i) income received in respect of units purchased in foreign currency; or

(ii) income by way of long-term capital gains arising from the transfer of units purchased in foreign currency.

The tax @ 10% shall be levied on gross income from the above sources and no deduction will be allowed under Sections 28 to 44C or Sections 57(i) and (iii) or deductions under Sections 80C to 80U. Further, the assessee shall not be entitled to take the indexed cost of acquisition in lieu of cost of acquisition of a long-term capital asset.

**Tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer (Section 115AD)**

(a) Where a Foreign Institutional Investor receives income in respect of securities other than income by way of dividends referred to in Section 115-O received in respect of securities other than unit referred to in Section 115AB, the following deductions shall not be allowed in computing the income from securities:

(i) Deductions under Sections 28 to 44C;

(ii) Deductions under Sections 57(i) and 57(iii);

(iii) Deductions under Sections 80C to 80U.

(b) Where the Foreign Institutional Investor earns capital gains (short-term or long-term) on the transfer of securities [mentioned in (a)], it shall not be entitled to claim deductions under Sections 80C to 80U against such capital gains.

The assessee shall not be eligible to calculate capital gains by converting selling price (in Indian currency) into foreign currency which it had brought to invest in securities.

Further, for computation of long-term capital gains, it shall not be entitled to opt indexed cost of acquisition in lieu of cost of acquisition:

<table>
<thead>
<tr>
<th>Type of Income</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>On short-term capital gains covered by section 111A</td>
<td>15%</td>
</tr>
<tr>
<td>On short-term capital gains on transfer of securities</td>
<td>30%</td>
</tr>
<tr>
<td>On long-term capital gains on transfer of securities</td>
<td>10%</td>
</tr>
<tr>
<td>Other income</td>
<td>20%</td>
</tr>
</tbody>
</table>
Tax on Income from bonds or Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer (Section 115AC)

The Finance Act, 2001, has substituted new Section 115AC for the existing section, to have effect from 1.4.2002, i.e. for assessment year 2002-03 and subsequent assessment years. This section extend the concessional rate of tax to Global Depository Receipts issued under other notified schemes of the Central Government also.

(a) Global Depository Receipts issued in accordance with a scheme notified by the Central Government in the official gazette against the initial issue of underlying shares of Indian company and purchased by the non-resident in foreign currency through an approved intermediary;

(b) Global Depository Receipts issued against shares of a public sector company sold by the Government and purchased by the non-resident in foreign currency through an approved intermediary;

(c) Global Depository Receipts re-issued against the existing underlying shares of an Indian company in accordance with such scheme as the Central Government may notify in the official gazette, and purchased by the non-resident in foreign currency through an approved intermediary;

(d) Global Depository Receipts issued against shares of a listed Indian company on the disinvestment of such company of its shareholdings in its listed subsidiary company. In accordance with such scheme as the Central Government may notify in the official gazette, and purchased by the non-resident in foreign currency through an approved intermediary.

Where however, the gross total income of the non-resident includes interest income or dividend other than dividends referred to in Section 115-O income from such bonds/GDRs as mentioned above, as well as other income, the gross total income in such case shall be reduced by the amount of such income (i.e. interest/dividend income) and the deduction under Chapter VI-A (i.e. Sections 80C to 80U) shall be applicable on the gross total income as so reduced.

<table>
<thead>
<tr>
<th>Income</th>
<th>Tax payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) where the total income consist only interest income/dividend income from such bonds/shares or long term capital gains arising from transfer of such bonds/shares</td>
<td>10% of such income</td>
</tr>
<tr>
<td>(b) where total income includes income as mentioned in (a) above plus other income</td>
<td>10% of income from (a) plus tax payable at normal rate on the balance income i.e. total income minus income of the type as mentioned in (a).</td>
</tr>
</tbody>
</table>

Return of Income

It shall not be necessary for a non-resident to furnish under Section 139(1) a
return of his income of:

(a) his total income in respect of which he is assessable under this Act during the previous year consisted only of interest income/dividend income as mentioned above; and

(b) the tax deductible at source under the provisions of Chapter XVII-B of the Act has been deducted from such income.

7.7 Tax on income from Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer

In this section

“Global Depository Receipts” means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.

“Information Technology Service” means any service which results from the use of any information technology software over a system of information technology products for realising value addition.

“Overseas Depository Bank” means a bank authorised by the issuing company to issue global depository receipts against issue of foreign currency convertible bonds or ordinary shares of the issuing company.

This section applies to a resident individual employed in an Indian company which is engaged in information technology software and information technology service.

If the total income of such assessee includes -

(a) dividend income (other than dividends referred to in Section 115-O) on global depository receipts of an Indian company engaged in information technology services, issued in accordance with a notified employees’ stock option scheme and purchased in foreign currency.

(b) income by way of long term capital gains arising from the transfer of global depository receipts referred above. Income tax shall be the aggregate of:

(i) tax @ 10% on dividend income referred to in point (a) above;

(ii) tax @ 10% on long term capital gains referred to in point (b) above;

(iii) the amount of income tax with which the resident employee would have been chargeable had his total income been reduced by the amounts referred to in point (a) and (b) above

It is further provided that if the gross total income of the resident employee consists of dividend income referred to in point (a) above, no deductions under any other provisions of this Act shall be allowed to him.
Further, if gross total income includes any income referred to in point (a) and (b) above, the gross total income shall be reduced by such incomes and deductions under the provisions of this Act shall be allowed on such reduced gross total income of the assessee. Also First and Second provisos to Section 48 shall not apply for computation of long term capital gains arising out of the transfer of such Global Depository Receipts being long term capital assets.

**Transaction not regarded as transfer**

A new clause (viia) has been inserted in Section 47 by the Finance Act, 1992 with effect from 1.6.1992, to provide that the transfer of bonds or shares referred to in Section 115AC(1) shall not be regarded as transfer for the purposes of computation of capital gains tax if such transfer is made outside India by one non-resident to another non-resident.

Certain Incomes of Non-residents taxable in India.

1. **Profits of business:** Such business profits of a non-resident as can reasonably be attributed to the operations of the business carried out in India are taxable. Note that where the non-resident is making purchase for exports, he is not required to pay tax on any profits he may earn by exports.

2. **Income from property in India:** The word property is of wide import for this purpose. It may include both movable and immovable property but it must be something tangible. If furniture or machinery is situated in India and is hired under an agreement by which the hire charges are payable outside India, such income shall be taxed in India.

3. **Income from any assets or source in India:** The words asset or source are of wide import and may include intangible property also like a debt or other chose-in-action. Any income from such sources would be taxable.

4. **Income from money brought into India and lent on interest:** If a non-resident assessee brings some money into India for lending purposes, any interest earned thereon will be deemed to accrue and arise in India and will, therefore, be taxed in India.

5. **Fees for Technical Services and Royalties:** Fees received by a foreign enterprise for technical services rendered to an Indian enterprise are taxable in India if either the services are rendered in India or the fees are received in India.

Royalties arise wholly in the country in which the patent, trade-mark process etc., is actually exploited. Thus, royalty received by a foreign patentee for the use of the patent in India shall be construed to arise in India, though the patent may be registered in a foreign country.

Where a foreign company receives royalties from an Indian concern in pursuance of an agreement made by it with the Indian concern after 31.3.61 or, receives fees for rendering technical services from an Indian concern in pursuance of an agreement made by it with the Indian concern after 29.2.1964 and, where such agreement has, in either case, been approved
by the Central Government, such income shall be taxed at a concessional rate of fifty per cent.

6. Double Taxation Relief: Double taxation arises where various sovereign countries exercise their power to subject the same person to taxes of a similar character on the same income. This may happen when he is taxed on the basis of his personal status, i.e., his nationality, domicile or residence as well as on the basis of place where the income is earned or received.

To avoid double taxation of the same income in two countries, the Central Government may enter into an agreement with the Government of any Country outside India:

(a) for the grant of relief in respect of income on which income-tax has been paid both under this Act and Income-tax Act in that country, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country.

In pursuance of Section 90, agreements for grant of relief on double taxation and agreement for avoidance of double taxation are executed by the Government of India from time to time. Some of the countries with which such agreements are in force are: Canada, Korea, New Zealand, Hungary, Czechoslovakia, Belgium, Sri Lanka, Swiss Federal Council, Sweden, Denmark, Finland, Great Britain, Norway, Japan, The Federal Republic of Germany, Republic of Austria, Greece, Romania, Republic of Lebanon, United Arab Republic, French Republic, Iran, Libya, Malaysia, Singapore, Tanzania, Zambia, Australia, Bulgaria, Ethiopia, Italy, Kuwait, USA, USSR.

Incomes not taxable in the hands of a non-resident

1. Income accruing to the non-resident on the sale of plant and machinery on instalment basis is not taxable.

2. Foreign Agent of an Indian Exporter: He is not liable to income-tax in India for the commission remitted to him by Indian exporter because he operates in his own country and no part of his income arises in India.

3. Non-resident person purchasing goods in India: A non-resident will not be liable to tax in India on any income attributable to operations confined to purchase of goods in India for export even though the non-resident has an office or an agency in India for this purpose.

4. Sale by a non-resident to Indian customer: Where the contracts to sell are made outside India and the sales are made on principal to principal basis, a non-resident is not assessable if he extends credit facilities. In cases where the non-resident has an agent in India but he sells directly to Indian customers, he will not be assessable notwithstanding that he pays an over-riding commission on all sales in India.
Test Your Knowledge

For which of the following incomes of the Off-shore Fund, the income tax shall be payable at the rate of 10%?

(a) Income received in respect of units purchased in foreign currency
(b) Income by way of long-term capital gains arising from the transfer of units purchased in foreign currency
(c) Both (a) and (b)
(d) Neither (a) nor (b)

Correct answer: (c)

2. Which of the following incomes of non-residents are taxable in India?

(a) Fees for technical services and royalties
(b) Income from property in India
(c) Profits earned by exports
(d) Income from money brought into India and lent on interest

Correct answer: (a), (b) and (d)

7.8 Profits of non-residents from Occasional Shipping Business (Section 172)

The provisions of Section 172 apply for the purpose of levy and recovery of tax in the case of any ship belonging to or chartered by a non-resident, which carries passengers, live-stock, mail or goods shipped at a port in India.

A sum equal to 7-1/2% of the aggregate of the amounts specified below shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”:

(i) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, live-stock, mail or goods shipped at any port in India; and

(ii) The amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, live-stock, mail or goods shipped at any port outside India.

However, if the assessee feels that it is in his interest to pay the tax on the basis of his total income, he may claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from Indian port falls, that an assessment be made of his total income of the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. If he so claims, any payment made during that previous year shall be treated as a payment of advance tax and the difference between the sum so paid and the amount of tax found payable by him on such assessment shall be paid by him or refunded to him as the case may be.
Before the departure from any port in India of a tram or ship, the master of the ship shall prepare and furnish to the Assessing Officer a return of the full amount paid or payable on account of the carriage of all passengers, live-stock, mail or goods shipped at that port since the last arrival of the ship thereat. If the Assessing Officer is satisfied that it is not possible to furnish the return required before the departure of the ship from the port and the master of the ship has made satisfactory arrangements for the filing of the return and payment of the tax by any other person on his behalf, the Assessing Officer may, if the return is filed within 30 days of the departure of the ship, deem the filing of the return by the person so authorised by the master.

On receipt of the return, the Assessing Officer shall assess the income and determine the sum payable as tax thereon at the rate in force applicable to the total income of a company which has not made the prescribed arrangements for declaration and payment of dividends within India.

A port clearance shall not be granted to a ship until the Port Authority is satisfied that tax assessable has been duly paid or that satisfactory arrangements have been made for the payment thereof.

In the case of Union of India v. Gosalia Shipping (P) Ltd., The Supreme Court has held that where a non-resident company hires a ship from another non-resident and loads the ship with own goods in India, neither the owner of the ship nor the lessee receives any amount on account of the carriage of the goods. No tax is, therefore, leviable under Section 172(2) [113 ITR 307 (S.C.)].

7.9 Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents (Section 44BBA)

(1) In the case of an assessee, being a non-resident engaged in the business of operation of aircraft, a sum equal to 5 per cent of the aggregate of the amounts specified in Sub-section (2) below shall be deemed to be the profits and gains of such business chargeable to tax under the head ‘Profits and gains of business or profession’.

(2) The amount referred to above shall be the following:

(a) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, live-stock, mail or goods from any place in India, and

(b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

With a view to simplifying the provisions relating to computation of taxable income of a non-resident, Section 44BBA provides that the income from such business shall be computed at a flat rate of 5% of the amount received or receivable by or on behalf of the taxpayer for carriage of passengers, live-stock, mail or goods from any place in India and the amount received or deemed to be received in India on account of such carriage from any place outside India.

Deductions of head office expenditure in case of non-residents (Section 44C)

In case of foreign companies having branches in India, deduction in respect of
head office expenditure is allowed in computing their income. Section 44C puts a ceiling on such deduction. Accordingly, in the case of assessee being a non-resident, while computing profits and gains of business, deduction in respect of head office expenditure shall not be allowed in excess of the following:

(a) an amount equal to 5% of the adjusted total income, or
(b) an amount equal to the average head office expenditure, or
(c) head office expenditure attributable to the business or profession of the assessee in India, whichever is the least.

In a case where the adjusted total income of the assessee is a loss, the amount under clause (a) shall be computed @ 5% of the average adjusted total income of the assessee. The term ‘head office expenditure’ means executive and general administration expenditure incurred by the assessee outside India including expenditure incurred in respect of the following:

(a) Rent, rates, taxes, repairs or insurance of premises outside India used for the purposes of the business or profession;
(b) Salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of any office outside India;
(c) Travelling by any employee or other person employed in or managing the affairs of any office outside India; and
(d) Such other matters connected with executive and general administration as may be prescribed.

7.10 Determination of Income in certain cases (Rule 10)

In any case in which the Assessing Officer (hereafter referred to as A.O.) is of opinion that actual amount of income accruing or arising to any non-resident person through or from any business connection or through or from any property in India or any asset or source of income in India or money lent at interest and brought into India in cash or kind cannot be definitely ascertained, the amount of such income for the purpose of assessment to income-tax may be calculated as under:

(i) at such percentage of the turnover so accruing or arising as the A.O. may consider to be reasonable; or
(ii) on any amount which bears the same proportion to the total profits and gains of the business of such person (profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business; or
(iii) in such other manner as the A.O. may deem suitable.

Where a business is carried on between a resident and a non-resident and it appears to the A.O., owing to the close connections between them, that the course of business is so arranged that the business transacted between them produces to the resident either no profits or less than the ordinary profits which might be expected to arise in that business, the A.O. shall determine the amount of profit which may
reasonably be deemed to have been derived therefrom and include such amount in the total income of the resident (Section 92).

7.11 Mode of Assessment

A non-resident can be taxed either directly or through his agent. Where there is no duly constituted agent in India, the A.O. may statutorily treat any of the following persons as an agent:

(i) who is employed by or on behalf of the non-resident; or

(ii) who has any business connection with the non-resident (he may reside anywhere in the world); or

(iii) from or through whom the non-resident is in receipt of any income whether directly or indirectly; or

(iv) who is the trustee of the non-resident; or

(v) who has acquired by means of a transfer a capital asset in India. Such person (transferee) may be resident or non-resident in India.

However, a broker in India who, in respect of any transactions, does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker shall not be deemed to be statutory agent of non-resident, if:

(i) the transactions are carried on in the ordinary course of business through the Indian Broker; and

(ii) the non-resident broker is carrying on such transactions in the ordinary course of his business and not as a principal.

If the A.O. wants to treat a person as the agent of a non-resident, he must serve on that person a notice of his intention of treating him as the agent of non-resident and give him an opportunity of being heard as to his liability. If the deemed agent is not satisfied by the order of the A.O., he may appeal to the Appellate Assistant Commissioner against treating him as the agent of a non-resident.

An agent shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially, i.e., submission of return, payment of advance tax, payment of tax on regular assessment, recovery of tax, reassessment, etc. He shall be liable to assessment in his own name and any such assessment shall be deemed to be made upon him in his representative capacity and the tax shall be levied and recovered from him in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him. However, his liability shall be restricted for the year for which he has been deemed to be an agent of the non-resident, after issuance to him of a notice to that effect by the A.O. If the A.O. wants to treat him as an agent of the non-resident for the following year also, a fresh notice for the purpose must be served upon him. Whenever he has been appointed an agent before the end of the previous year, he shall be liable for the payment of tax in advance.

Rights of an Agent:

(i) Where an agent pays any sum under this Act on behalf of a non-resident, he
shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any money that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.

(ii) Any person who apprehends that he may be assessed as an agent may retain out of any money payable by him to the principal, a sum equal to his estimated tax liability. In case of disagreement between the principal and the agent as to the amount to be so retained, the agent may secure from the A.O. a certificate stating the amount to be so retained pending final settlement of the liability. The certificate so obtained shall be his warrant for retaining that amount.

The amount recoverable from the agent at the time of final settlement shall not exceed the amount specified in the certificate, except to the extent to which the agent at such time has in his hands additional assets of the principal. The liability of the statutory agent is personal and not conditional upon his having in hand any funds of the non-resident. If he fails to recover the amount of tax paid by him from the non-resident (on whose behalf it has been paid), he cannot claim it as a bad debt or as a business loss on ordinary principles of commercial accounting.

Incomes escaping assessment

Where the income of non-resident has escaped assessment, a notice to the statutory agent of the non-resident for assessment or reassessment cannot be issued after expiry of a period of two years from the end of the relevant assessment year.

7.12 Recovery of Tax

The tax on the income of a non-resident may be recovered as follows:

(i) Deduction of tax at source: The amount of the tax should be deducted at the prescribed rates by the person who makes the payment to a non-resident.

(ii) From his Agent or Assets: All property in India belonging to the non-resident principal can be proceeded against for the recovery of tax, on the basis of the assessment made against his statutory agent.

(iii) Where any property of the non-resident principal is vested in the representative assessee or is under the control or management of the representative assessee, the same may be proceeded against, whether the demand is raised against the representative assessee or against, the beneficiary direct.

(iv) If there is no property in India of the non-resident at the time of making an assessment, the Assessing Officer may wait till any property of the non-resident comes into India.

The ordinary period of limitation applicable to the commencement of proceedings to recover tax is one year from the end of the financial year in which the demand is made. However, arrears of tax assessed on a statutory agent in respect of income deemed to accrue or arise in India may be recovered from any assets of the non-resident which are, or may, at any time come within India. Consequently, such tax may be realised irrespective of any limitation by way of time.
Test Your Knowledge

Suppose you are an A.O., which of the following persons would you like to treat as an agent?

(a) A person who is the trustee of the non-resident

(b) A person who has acquired by means of a transfer a capital asset in India.

(c) Both (a) and (b)

(d) Neither (a) nor (b)

Correct answer: (c)

7.13 AGRICULTURAL INCOME

Section 10(1) of the Act exempts agricultural income in computing the total income of any person. As per the Article 270 of the Constitution of India, the Central Legislature cannot impose tax on agricultural income. The State Legislatures are only competent to tax agricultural income. In exercise of the powers under the Constitution, many State Governments (e.g., Assam, West Bengal, Tamil Nadu, Kerala, Bihar, Andhra Pradesh, Madhya Pradesh, Orissa, Rajasthan and Uttar Pradesh) have imposed tax on agricultural income.

Though the tax on agricultural income is exempted but with effect from the assessment year 1974-75 the agricultural income has become a factor in the determination of the tax on the non-agricultural income. Therefore it becomes necessary to determine what agricultural income is.

DEFINITION OF AGRICULTURAL INCOME:

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

Agricultural income means—

(a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes;

(b) Any income derived from such land by—

(i) agriculture; or

(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or

(iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (ii) of this sub-clause;

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

Provided that—

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

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

(A) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(B) in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (A), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette.

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

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

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

CONDITIONS TO BE SATISFIED FOR AGRICULTURAL INCOME:

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

(a) Rent or revenue derived from land:

— The word rent denotes the payment of money either in cash or in kind by one person to another (owner of the land) in respect of grant of right to use land.

— The recipient of rent or revenue should be the owner of the land.
— The expression revenue is used in the broader sense of return, yield or income, and not in the sense of land revenue.

— Income is said to be derived from land only if the land is the immediate and effective source of the income and not the secondary and indirect source. Thus interest on arrears of rent payable in respect of agricultural land is not agricultural income because the source of income (interest) is not from land but it is from rent which is a secondary source of income and is taxable under the head Income from other sources. [CIT v. Kamakshya Narain Singh [(1948) 16 ITR 325].

(b) Land must be situated in India:

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

(c) Land must be used for agricultural purpose:

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

(i) Basic operation:

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

(ii) Subsequent operations:

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

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

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

According to Section 2(1A) which of the following conditions are pre requisites for agricultural income?

(a) Rent or revenue should be derived from land
(b) The land must be situated in India
(c) The land must be used for dairy farming
(d) The land must be used for agricultural purpose

Correct answer: (a), (b) and (d)

CONCEPT OF AGRICULTURAL INCOME:

Agricultural Income means and includes

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

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

III. Income from making the produce fit to be taken to market
   The crop as harvested might not find a market. If, in order to make the product a saleable commodity, the cultivator or receiver of rent-in-kind performs some operation (manual or mechanical) and enhances the value of the produce, the enhancement of value of the produce is also agriculture income. Such income to be regarded as agricultural income, the following conditions must be satisfied:
   (i) The operation must be one which is ordinarily employed by the cultivator to make the produce fit for market, i.e., threshing, winnowing, cleaning, drying, etc.
   (ii) There is no market (ready and willing and not a theoretical market) for the produce as received from the farm.
   (iii) The process to make it marketable has been performed either by the cultivator or receiver of rent-in-kind.
   (iv) The produce must not change its original character.

Example:

(a) There is no ready market for raw coffee in the green state. It has to be dried-up and cured before it can be sold. In the same way, the conversion of the green tobacco leaves into fluecured tobacco is a must before sale. On the other hand, there is a ready market of kapas or
unginned cotton. If the farmer sells the ginned cotton, the additional income (difference between the selling price of ginned cotton and unginned cotton) is not agricultural income and is therefore liable to tax.

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

IV. Income from sale of produce:

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

V. Income from Building:

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

(a) (i) If the land-lord receives rent in cash, it is owned and occupied by him; or

(ii) If the land-lord receives rent-in-kind, it is occupied by him - whether owned or not; or

(iii) if it is occupied by the cultivator - whether owned by him or not;

(b) If it is on or in the immediate vicinity of the agricultural land;

(c) If it is required as a dwelling-house or as a store house or as an out-house by the land-lord or cultivator;

(d) If it is required by reason of the land-lords or cultivators connection with the land, i.e., either the building is required to make the produce fit to be taken to the market or there is a sufficient quantity of produce which requires a store house or there are numerous tenants and it is necessary to stay there to collect the rent or it is necessary for the cultivator to be there to look after the farm.

(e) (i) The land is assessed to land revenue in India; or

(ii) The land is subject to land revenue or local rate assessed and collected by the officers of the Government - either Central or State for the benefit of local bodies. Where the land is not so assessed, the building should not be situated:

(a) in an area of municipality (whether known as Municipal Corporation, Notified Area Committee, Town Area Committee, or by any other name or Cantonment Board whose population according to the latest census figures published is 10,000 or more; or
(b) in a notified area within such limits of a Municipality, etc., as may be notified by Government.

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

INCOMES CONNECTED WITH LAND BUT NOT AGRICULTURAL INCOMES

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

(a) Income from spontaneous growth of grass, trees or bamboos;
(b) Dividend from a company engaged in agriculture;
(c) Salary of a farm manager;
(d) Income from mines;
(e) Income from stone quarries;
(f) Income from fisheries;
(g) Income from brick making;
(h) Income from supply of water for irrigation purposes;
(i) Profit accruing from the purchase of a standing crop and resale thereof after harvest;
(j) Income from animal kingdom.

PARTLY AGRICULTURAL INCOME [Rules 7 and 8 of the Income-tax Rules, 1962]

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

(a) where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the relevant previous year;

(b) where agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any process aforesaid, the aggregate of—

(i) the expenses of cultivation;
(ii) the land revenue or rent paid for the area in which it was grown; and
(iii) such amount as the Assessing Officer finds, having regard to all the circumstances in each case, to represent a reasonable profit.

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

**Income from manufacture of rubber (Rule 7A)**

w.e.f. AY 2002-03

1. Income derived from the sale of centrifuged latex or cenex or latex based crepes (such as pale latex crepe) or brown crepes (such as estate brown crepe, remilled crepe, smoked blanket crepe or flat bark crepe) or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and thirty-five percent of such income shall be deemed to be income liable to tax.

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

**Income from the manufacture of coffee (Rule 7B)**

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

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

**Income from growing and manufacturing of tea (Rule 8)**

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

In computing the income, with all other costs, the cost of planting bushes in replacement of bushes that have died or become permanently useless shall be deducted. (However, if the assessee has received any tax-free subsidy for replacement of the bushes, such amount shall not be deducted in computing the income).
<table>
<thead>
<tr>
<th>Nature of income</th>
<th>Income tax Rule applicable</th>
<th>Amount of agricultural income</th>
<th>Amount of non agricultural income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from sale of tea manufactured or grown in India</td>
<td>Rule 8</td>
<td>60% of such income</td>
<td>40% of such income</td>
</tr>
<tr>
<td>Income from growing and manufacturing of rubber</td>
<td>Rule 7A</td>
<td>65% of such income</td>
<td>35% of such income</td>
</tr>
<tr>
<td>Income derived from sale of coffee grown and manufactured in India</td>
<td>Rule 7B</td>
<td>75% of such income</td>
<td>25% of such income</td>
</tr>
</tbody>
</table>

**Treatment of Agricultural Income and Non-Agricultural Income**

**Partial Integration:**

— As observed earlier, the Finance (No. 2) Act, 1977 has introduced certain modifications in computation of tax payable where the assessee (being an individual, association of persons or body of individuals) has both agricultural income and non-agricultural income.

— It may be mentioned that for the first time Finance Act, 1973 introduced the scheme of inclusion of agricultural income in the total income for the limited purpose of determining the amount of tax payable on the non-agricultural income.

— The scheme applies only to those assesses who have simultaneously net agricultural income exceeding ₹ 5,000 and taxable non-agricultural income i.e. non agricultural income exceeds the exemption limit.

<table>
<thead>
<tr>
<th>Test Your Knowledge</th>
</tr>
</thead>
<tbody>
<tr>
<td>If the assessee has received any tax-free subsidy for replacement of tea plantation bushes, such amount shall be deducted in computing the income.</td>
</tr>
</tbody>
</table>

- True
- False

Correct answer: False

**7.14 Determination of Tax Liability**

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

1. Compute the net agricultural income as if it were income chargeable to income-tax under the head: “Income from other sources”.

2. Aggregate agricultural and non-agricultural income of the assessee and calculate income-tax on the aggregate income as if such aggregate income were the total income.
3. Increase the net agricultural income by the first slab of income on which tax is charged at nil rate and calculate income-tax on net agricultural income, so increased, as if such income were the total income of the assessee.

4. The amount of income-tax determined at (2) will be reduced by the amount of income-tax determined at (3).

5. The amount so arrived at will be the total income-tax payable by the assessee.

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

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

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

**Illustration 1:**

Non-agricultural income ₹ 1,60,000. Net agricultural income ₹ 40,000.

**Solution:**

No income-tax payable as the non-agricultural income does not exceed ₹ 1,60,000.

**Illustration 2:**

Non-agricultural income ₹ 1,62,000. Net agricultural income ₹ 40,000.

**Solution:**

<table>
<thead>
<tr>
<th>Step 1</th>
<th>Non-agricultural income + Net Agricultural income</th>
<th>₹ 2,02,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Income-tax thereon (including education cess &amp; SHEC)</td>
<td>₹ 4,326</td>
</tr>
</tbody>
</table>

| Step 2               | Net agricultural income as increased by a sum of ₹ 1,60,000 + 40,000 | ₹ 2,00,000 |
|----------------------| Income-tax thereon (including education cess & SHEC) | ₹ 4,120 |

| Step 3               | Deduct tax arrived at in step 2 from tax arrived at in step 1 (₹ 4,326 – ₹ 4,120) to arrive at tax payable. | ₹ 206 |

**Test Your Knowledge**

Income derived from the sale of coffee grown and manufactured by the seller in India shall be computed as if it were income derived from business, and 35% of such income shall be deemed to be income liable to tax.

- True
- False

Correct answer: False
COMPUTATION OF TAX WHEN THE ASSESSEE HAS AGRICULTURAL INCOME

From Assessment Year 2006-07 the tax in the case of individuals, Hindu Undivided Families etc. having agricultural income will be computed as follows:

**Rule 1** - Net agricultural income of the nature referred in Section 2(1A)(a) shall be computed as if it were income chargeable to income-tax under that Act under the head "Income from other sources".

**Rule 2** - The net agricultural income of the nature referred in Section 2(1A)(b) and 2(1A)(c) [other than income derived from any building required as a dwelling-house by the receiver of the rent or revenue or the cultivator or the receiver of rent-in-kind referred to in the said sub-clause (c)] shall be computed as if it were income chargeable under the head "Profits and gains of business or profession".

**Rule 3** - Agricultural income of the nature referred to Section 2(1A)(c) of the Income-tax Act, being income derived from any building required as a dwelling-house by the receiver of the rent or revenue or the cultivator or receiver of rent-in-kind referred to in the said sub-clause (c) shall be computed as if it were income chargeable under "Income from house property".

**Rule 4** - Notwithstanding anything contained in any other provisions of these rules, in a case

— where the assessee derives income from sale of tea grown and manufactured by him in India, such income shall be computed in accordance with the rule 8 of the Income-tax Rules, 1962, and sixty per cent of such income shall be regarded as the agricultural income of the assessee;

— where the assessee derives income from the sale of centrifuged latex or cenex or latex based (such as pale latex crepe) or brown crepes (such as estate brown crepe, re-milled crepe, smoked blanket crepe or flat bark crepe) or technically specified block rubbers manufactured or processed by him from rubber plants grown by him in India, such income shall be computed in accordance with rule 7A of the Income-tax Rules, 1962 and sixty-five per cent of such income shall be regarded as the agricultural income of the assessee.

**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 under the Income-tax Act or has total income not exceeding the maximum amount not chargeable to tax in the case of an association of persons or a body of individuals (other than a Hindu undivided family or a company or a firm) but has any agricultural income then, the agricultural income or loss of the association or body shall be computed in accordance with these rules and the share of the assessee in agricultural income or loss so computed shall be regarded as the agricultural income or loss of the assessee.

**Rule 6** - Where the result of the computation for the previous year in respect of any source of agricultural income is a loss, such loss shall be set off against the income of the assessee, if any, for that previous year from any other source of agricultural income.

(Not applicable for computation of Agricultural income of a partner of a firm).
Rule 7 - Any sum payable by the assessee on account of any tax levied by the State Government on agricultural income shall be deducted in computing the agricultural income.

Rule 8 - The unabsorbed loss from agricultural activities during the previous year 2002-03 to 2010-2011 will be set off against the agricultural income of assessment year 2012-13 in chronological order. Likewise, an unabsorbed loss from agriculture during the previous year relevant to the assessment year 2003-04 to 2010-11 will be taken into account in determining the net agricultural income for the purpose of payment of advance tax during the financial year 2011-12. 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 loss) cannot claim the set off as above.

Rule 9 - Where the net result of the computation made in accordance with these rules is a loss, the loss so computed shall be ignored and the net agricultural income shall be deemed to be nil.

Rule 10 - The provisions of the Income-tax Act relating to procedure for assessment (including the provisions of Section 288A relating to rounding off of income) shall, with the necessary modifications, apply in relation to the computation of the net agricultural income of the assessee as they apply in relation to the assessment of the total income.

Rule 11 - For the purposes of computing the net agricultural income of the assessee, the Assessing Officer shall have the same powers as he has under the Income-tax Act for the purpose of assessment of the total income.

LESSON ROUND UP

- Taxation of Individual and Hindu Undivided family is discussed in the initial section of the Chapter.
- Later tax implications on firms, AOPs, cooperative societies and non-residents is discussed.
- A special feature on tonnage tax scheme (under sections 115V to 115VZC) is discussed.
- With regard to non-residents tax exemptions, concessions under various securities, profits from occasional shipping business etc. has been discussed in this chapter.
- Concept of Agriculture Income.
SELF TEST QUESTIONS

1. Explain how the scope of total income and the extent of tax liability of an individual are determined.

2. (a) What are the provisions relating to assessment of a HUF after its partition?
   
   (b) Explain the terms ‘Partition’, ‘Partial Partition’, and ‘Co-larceners’.

3. Answer the following questions:
   
   (a) Can a widow be the Karta of a H.U.F.?
   
   (b) Can a H.U.F. be a partner in a firm?
   
   (c) Can there be a Hindu undivided family with a sole surviving male member and widows?
   
   (d) Can uncle and nephew form a H.U.F.?
   
   (e) Can a junior member act as the Karta of a joint Hindu family?

4. (a) Mr. Mukesh Bharadwaj, the Karta of a H.U.F. was one of the promoters of a company and the Articles of Association of the company provided that he would be the first director of the company. Mr. Mukesh Bharadwaj acquired a number of shares in the company and so did his brothers. The amount required to purchase the shares was paid out of the family’s income. In fact, Mr. Mukesh Bharadwaj and his brothers were the promoters and principal shareholders of the company for the year ended 31.3.1997. Mr. Mukesh Bharadwaj received ₹ 60,000 as remuneration in his capacity as the managing director, ₹ 2,500 as directors’ fees and ₹ 12,000 as dividends on the shares held in his name. In the foregoing circumstances, should all the amounts received by Mr. Mukesh Bharadwaj be treated as his personal income or that of the H.U.F.

   (b) Mr. Ram, a Hindu individual governed by the Dayabhaga School of Law died intestate (without a will) leaving his widow and a son. He owned certain house properties. Is the income from house properties assessable in the hands of the widow and son according to their individual share or in the hands of a H.U.F. consisting the widow and the son?

5. What is the New Scheme of Taxation of a firm?

6. Explain in brief the condition for allowability of deduction of interest to a partner.

7. Explain the difference between the change in constitution and succession of a firm. Illustrate.
8. What is meant by Association of Persons? How is it formed?
9. Discuss tax liability of an Association of Persons.
10. 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.
11. Explain the following under the Income-tax Act:
   (a) “Co-operative Society”.
   (b) “Urban Consumers” Co-operative Society”.
12. Explain the deductions which are allowed under Section 80P to arrive at the total income of a co-operative society.
13. Explain the exemptions and concessions available to non-resident assesses.
14. Under what circumstances can a person be treated as the agent of a non-resident?
15. Mr. A fails to deduct income-tax at source of a sum of ₹ 35,000 paid to Mr. B of U.S.A. who is a non-resident in India. The amount is paid to him as interest on loan taken for the purposes of business. How would you deal with this item as an Assessing Officer?
16. What are the rights of a statutory agent of a non-resident?
This chapter deals with filing of returns, signatures, e-filings, assessment and re-assessment with respect to income earned by an assessee in relevant previous year. The Department of Income Tax and CBDT for the benefit of the tax payers introduced e-filing system of return through inter-net which also being discussed. The intricacies of tax proceedings with respect to assessment/re-assessment is discussed in detail.

LEARNING OBJECTIVES
This chapter covers the following topics/concepts:
- Income-Tax Authorities (Appointment, Jurisdiction and Powers) (Section 116)
- Appointment of Income-tax Authorities (Section 117)
- Control of Income-tax Authorities (Section 118)
- The Central Board of Direct Taxes
- Appointment and Working of the Board
- Jurisdiction
- Power
- Jurisdiction of Income-tax Authorities (Section 120)
- Director-General or Director of Income-tax
- Chief Commissioner or Commissioner of Income-tax
- Commissioner of Income-tax (Appeals)
- Procedure for Assessment
- Return of Income [(Section 139 (1)]
- E-filing of Return
- Due date for filing return of income
- Bulk Filing of Return
- Power to Central Government:
- Return of Loss- Section 139(3)
- Belated Return – Section 139(4)
- Return of Income of Charitable trust and Institutions – Section 139(4A) Return of income of Political Party- Section 139(4B)
8.1 INCOME-TAX AUTHORITIES (Appointment, Jurisdiction and Powers) (Section 116)

The following are the income-tax authorities who are statutorily empowered to administer the law of Income-tax:

(i) The Central Board of Direct Taxes, constituted under the Central Boards of Revenue Act, 1963;

(ii) Directors-General of Income-tax or Chief Commissioners of Income-tax;

(iii) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals);

(iv) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals);

(v) Joint Directors of Income tax or Joint Commissioners of Income-tax.

(vi) Deputy Directors of Income-tax or Deputy Commissioners of Income-tax or Deputy Commissioners of Income-tax (Appeals);

(vii) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax;

(viii) Income-tax (Assessing) Officers;

(ix) Tax Recovery Officers;

(x) Inspectors of Income-tax.

The provisions of the Income-tax Act contained in Sections 117 to 136 specify the procedure relating to the appointment of the various income-tax authorities, their powers, functions, jurisdiction and control. In addition to the various provisions contained in these sections, the Income-tax Department follows the system of functional allocation and distribution of work with a view to specialising and concentrating in the various areas of income-tax assessment, procedure, collection, recovery, refund, appeals, etc.

For all purposes of the Income-tax Act, the Income Tax authorities are vested with the various powers which are vested in a Court of Law under the Code of Civil
Procedure while trying a suit in respect of any case. More particularly, the provisions of the Code of Civil Procedure and the powers granted to the tax authorities under the code would in respect of:

(a) discovery and inspection;
(b) enforcing the attendance, including any officer of a Bank and examining him on oath;
(c) compelling the production of books of accounts and the documents;
(d) collecting certain information [Section 133B - inserted by the Finance Act, 1986];
(e) issuing commissions and summons.

The Finance Act, 1985 has added that w.e.f. 1.4.1973 every income-tax authority shall be deemed to be a Civil Court for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973. The powers granted are generally quasi-judicial. In particular, the powers of income-tax authorities relate to discovery, production of evidence etc., searches and seizures, application of retained assets, power to call for information from various parties, authorities and bodies, powers of survey, powers relating to the inspection of the registers of companies etc. Further, all proceedings under the Income-tax Act before any income-tax authority must be deemed to be judicial proceedings within the meaning of Sections 193 and 228 and for purposes of Section 196 of the Indian Penal Code. For a detailed Study of the various powers, functions, jurisdiction, etc., of the different classes of income-tax authorities and the general scheme of administration of the Income-tax Act, students may refer to the relevant provisions of the Income-tax Act.

8.2 Appointment of Income-tax Authorities (Section 117)

The Central Government may appoint such persons as it thinks fit to be income-tax authorities. Where an income-tax authority is authorised by the Board, it may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its function.

8.3 Control of Income-tax Authorities (Section 118)

The Board is empowered to control the income-tax authorities. It may notify that any income-tax authority will be sub-ordinate to such other income-tax authority or authorities as may be specified in the notification.

8.4 THE CENTRAL BOARD OF DIRECT TAXES

8.5 Appointment and Working of the Board

The Central Board of Direct Taxes was created under the Central Boards of Revenue Act, 1963 [Section 2(12)]. The Board in its working is closely associated with the Union Ministry of Finance.

8.6 Jurisdiction

It is the topmost executive authority in the sphere of direct taxes. Its powers of administration supervision and control extend over the whole department.
8.7 Power

(i) **Power to make Rules:** It has the power to make rules (under Section 295) for carrying out the purposes of this Act. The Rules may be made for whole or any part of India.

(ii) **To issue instructions:** It may issue orders, instructions and directions to all officers and persons employed in the execution of the Act (Section 119). However, it cannot interfere with the discretion of the Commissioner (Appeals), in the exercise of the appellate functions [Section 119(1)(b)] and it cannot direct the Assessing Officer or any other income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner [*J.K. Synthetics Ltd. v. CBDT* (1972) 83 ITR 335 (SC)] [Section 119(1)(a)].

(iii) **Power to relax mandatory provisions:** The Board is empowered to relax the provision relating to the charge of mandatory interest for defaults in deduction of tax at source, or payment of such tax [under Section 201(1A)] or payment of advance tax (Section 211) or interest for defaults in furnishing return (Section 234A) or interest for defaults in payment of advance tax (under Section 234B or Section 234C) or assessment and recovery of tax.

The Board is also empowered to relax the provisions relating to the computation of total income and deductions to be made in computing total income in cases of genuine hardship. It can be done by a general or special order and for reasons to be specified therein.

(iv) **Power to admit belated refund application:** To avoid genuine hardship in any case or class of cases, the Board may authorise any income-tax authority, not being Commissioner (Appeals) to admit belated application or claim for any exemption, deduction, refund or any other relief [Section 119(2)(b)].

(v) **Power to decide jurisdiction:** The Board is empowered to decide jurisdictional matters of any income-tax authority and assign to them such functions as are to be performed by them (Section 120).

(vi) **Power to disclose information:** The Board may disclose information relating to any assessee, to any officer, authority, or body performing any functions under any tax law relating to the imposition of any tax, duty or cess or dealing in foreign exchange under Foreign Exchange Management Act, 1999, if it considers such disclosure in public interest. The Board may also authorise any other income-tax authority to disclose such information (Section 138). The provision is intended to facilitate exchange of information about tax evaders.

8.8 Jurisdiction of Income-tax Authorities (Section 120)

Income-tax authorities are required to exercise or perform such powers or functions as are assigned to them by the Board [Section 120(1)].

Any income-tax authority, being an authority higher in rank, may, if so directed by the Board exercise the powers and performs the functions of the income-tax authority
lower in rank and any such direction issued by the Board shall be deemed to be a direction issued under Sub-section (1).

The Board may authorise any other income-tax authority to issue orders in writing for the exercise of the powers and performance of the functions by all or any of the income-tax authority who are subordinate to it [Section 120(2)]. While issuing such directions, the Board or any other income-tax authority authorised by it may take into account (i) territorial area, (ii) persons or classes of persons, (iii) incomes or classes of income, and (iv) cases or classes of cases [Section 120(3)].

8.9 Director-General or Director of Income-tax

He has the following powers:

(a) *To appoint an income-tax authority below the rank of an Assistant Commissioner (Section 117)*: If so authorised by the Central Government a Director-General or Director may appoint an income-tax authority below the rank of Assistant Commissioner.

(b) *To delegate the powers of Assessing Officer to Joint Commissioner (Section 120)*: Where Director-General or Director is so authorised by the Board, he may delegate the powers and functions of the Assessing Officer to Joint Commissioner.

(c) *To transfer cases (Section 127)*: The Director-General may transfer any case from one or more Assessing Officers subordinate to him to any other Assessing Officer also subordinate to him.

(d) *Enquiry into concealment [Section 131(1A)]*: If the Director-General or Director or Deputy Director or Assistant Director (w.e.f. 1.6.1988) has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, he is empowered to make any enquiry or investigation relating thereto notwithstanding that no proceedings with respect to such person or class of persons are pending before him [Section 131(1A)].

(e) *Search and seizure [Section 132(1)]*: Where the Director-General or Director or Chief Commissioner or Commissioner in consequence of information in his possession has reason to believe that (a) any person to whom notice has been issued in respect of discovery and inspection etc. [under Section 131(1)] or (b) any person to whom notice has been issued to produce accounts or documents [under Section 142(1)], has failed to do so far he is not likely to produce such accounts or documents, or (c) any person is in possession of undisclosed income or property, he is empowered [under Section 132(1)] to authorise any Deputy Director, Deputy Commissioner, Assistant Director (Assistant Commissioner w.e.f. 1.4.1989) or Assessing Officer to enter and search any building, place, vessel, vehicle or aircraft, where he has reason to suspect about their availability and seize any such books of accounts, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search.

(f) *To requisition books of account/Assets etc. (Section 132A)*: Where any books of account or documents have been taken into custody by any officer
or authority under any other law (e.g. by Commissioner or Customs, Sales Tax Commissioner etc.) and the Director General or Director or the Chief Commissioner or Commissioner, in consequence of information in his possession, has reason to believe that (i) any person, required to produce such accounts/documents prior to their acquisition under any other law, has failed to do so, or (ii) such accounts or documents will be useful for any proceeding under income-tax law but such person would not produce them on their return by the officer or authority under any other law, or (iii) any assets represent income or property which has not been, or would not have been disclosed by any person from whose possession or control such assets have been taken into custody by any officer or authority under any other law, he may authorise any Deputy Director, Deputy Commissioner, Assistant Director, Assistant Commissioner or Income-tax Officer to require such officer or authority under any other law to deliver such books of account or documents or such assets to the requisitioning officer under income-tax law. On a requisition being made, such officer or authority under any other law is required to deliver such books of accounts or documents or assets to the requisitioning officer either forthwith or after such time when it is no longer necessary to retain them in his custody.

(g) **To make any enquiry (Section 135):** The Director-General or Director is competent to make any enquiry under this Act.

**8.10 Chief Commissioner or Commissioner of Income-tax**

He has the following powers:

(i) **To appoint an income-tax authority below the rank of Assistant Commissioner (Section 117):** If so authorised by the Central Government, a Chief Commissioner or Commissioner may appoint an income-tax authority below the rank of Assistant Commissioner.

(ii) **To delegate the powers of Assessing Officer to Deputy Commissioner (Section 120):** Where Chief Commissioner or Commissioner is so authorised by the Board, he may delegate the powers and functions of the Assessing Officer to Joint Director or Joint Commissioner.

(iii) **To transfer case (Section 127):** The Chief Commissioner or Commissioner is empowered to transfer any case from any Assessing Officers to any other Assessing Officer or Assessing Officers.

(iv) **Power regarding discovery, production of evidence etc. (Section 131):** The Chief Commissioner or Commissioner has the same powers as are vested in a Court under the Code of Civil Procedure in respect of discovery and inspection, compelling production of books of accounts and other documents (relating to any period), issuing commissions enforcing the attendance of any person, including any officer of a banking company and examining him on oath.

The Commissioner may impound or retain any books of accounts or other documents produced before him for such time as he thinks fit [Section 131(3)]. Where such power is exercised by the Assessing Officer, he has to
record reasons before impounding the books of accounts or documents. The Assessing Officer or Assistant Commissioner cannot retain the books of accounts/documents for a period exceeding 15 days without prior approval of the Chief Commissioner or Director-General or Commissioner [Section 131(3)].

(v) Search and seizure (Section 132): Like Director-General or Director, the Chief Commissioner or Commissioner of Income-tax has also got the powers of search and seizure.

(vi) To requisition books of accounts etc. (Section 132A): Like Director-General or Director of Income-tax, the Chief Commissioner or Commissioner is also vested with the power to requisition books of accounts.

(vii) Power of survey (Section 133A): An income-tax authority (i.e. Commissioner, Joint Commissioner, Deputy Commissioner, Director, Joint Director, Deputy Director, Assistant Director or an Assessing Officer) is empowered to enter any place, within the limits of the area assigned to him, where business is carried on or where any books of accounts/documents, cash, stocks or other valuable articles relating to business are kept. An income-tax authority may (a) place marks of identification on the books of accounts or other documents inspected by him and make or cause to be made extracts or copies therefrom, or (b) make an inventory of any cash, stock or other valuable articles or things checked or verified by him, or (c) record the statement of any person which may be useful or relevant to any proceeding under this Act. Books of accounts or other documents, any cash, stock or other valuable articles cannot be removed by the income-tax authority from such place. The entry (a) to a business place should be made during the hours at which such place is open for the conduct of the business, and (b) to any other place only after sun rise and before sun set. An entry to a place not falling within the jurisdiction of an income-tax authority, should be made with the prior approval of that income-tax authority who exercises jurisdiction over that place.

Where an assessee incurs an ostentatious expenditure on any function, ceremony, the income-tax authority is empowered to collect information about such expenditure from the assessee or any other person who is likely to possess information in this connection and may record their statement which may be used thereafter as an evidence. This may be done at time such function or ceremony is over.

(viii) To make any enquiry (Section 135): The Chief Commissioner or Commissioner is competent to make any enquiry under this Act.

(ix) Disclosure of information respecting assesses (Section 138): Where a person makes an application to the Chief Commissioner or Commissioner in the prescribed form for any information relating to any assessee in respect of any assessment, he may furnish the information asked for in respect of that assessment if he satisfied that such disclosure is in public interest.

(x) To sanction reopening of the assessment after the expiry of four years [Section 151(2)]: The assessment of an income which has escaped
assessment can be reopened after the expiry of four years from the end of the relevant assessment year only if the Chief Commissioner or Commissioner has sanctioned such reopening.

(xii) To approve withholding of refund in certain cases (Section 241): Where any proceeding is pending against the assessee and the Assessing Officer is of the opinion that the grant of the refund may adversely affect the revenue, the Chief Commissioner or Commissioner may authorise the Assessing Officer to withhold the refund till such time as the Chief Commissioner or Commissioner may determine.

(xii) Set-off of refund against arrears of tax (Section 245): The Chief Commissioner or Commissioner is empowered to set off the amount of refund or any part thereof due to any person against the arrears of the tax due from such person. Any intimation in writing to this effect should be given to such person.

(xiii) To direct the Assessing Officer to prefer appeal to the Tribunal against A.A.C.’s order [Section 253(2)]: The Commissioner may, if he objects to any order passed by a Commissioner (Appeals), direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

(xiv) To revise any order passed by the Assessing Officer which is prejudicial to revenue (Section 263): The Commissioner may revise any order passed by the Assessing Officer which is prejudicial to the interest or revenue.

(xv) Revision of any order passed by a subordinate authority on application by the assessee or suo motu (Section 264): The Commissioner may revise either on his own motion or on an application made by the assessee within the prescribed time for such revision, any order passed by an authority subordinate to him. He may pass such order thereon, not being an order prejudicial to the assessee as he may think fit.

8.11 Commissioner of Income-tax (Appeals)

The Commissioner of Income-tax (Appeals) is an appellate authority. It is vested with the judicial powers:

(1) Power regarding discovery, production of evidence (Section 131): Like Chief Commissioner or Commissioner, the power regarding discovery, production of evidence etc., can also be exercised by the Commissioner (Appeals).

(2) Power to call for information (Section 133): The Commissioner of Income-tax (Appeals) may, for the purposes of this Act:

(a) require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares;

(b) require any Hindu Undivided Family to furnish him with a return of the names and addresses of the manager and the members of the family;
require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian or agent, and of their addresses;

d) require any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity together with particulars of such such payments made;

e) require any dealer, broker or agent or any person concerned in the management of a stock or Commodity Exchange to furnish a statement of the names and addresses of all persons to whom he or the Exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the Exchange has received any such sum, together with particulars of all such payments and receipts;

f) require any person, including a banking company or any officer thereof, to furnish information in relation to such point or matter or to furnish statements of accounts and affairs verified in the specified manner, giving such information as may be required by him.

3) **Power to inspect register of companies (Section 134):** The Commissioner (Appeals) may inspect and, if necessary, take copies or cause copies to be taken, of any register of members, debentureholders or mortgagees of any company or of any entry in such register. The Commissioner (Appeals) may also authorise (in writing) any person subordinate to him to inspect and, if necessary, take copies or registers as aforesaid.

4) **Set-off of refund against arrears of tax (Section 245):** The Commissioner (Appeals) is empowered to set off the amount of refund or any part thereof due to any person against the arrears of tax due from such person. An intimation in writing to this effect should be given to such person.

5) **Disposal of appeal (Section 251):** In disposing of an appeal, the Commissioner (Appeals) has the following powers:

   a) in an appeal against an order of assessment he may confirm, reduce, enhance or annual the assessment, or he may set aside the assessment and refer back to the Assessing Officer for making a fresh assessment in accordance with such directions as given by him.

   b) in an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or reduce the penalty.

   c) in any other case, he may pass such order in appeals as he thinks fit.

It may be noted that an assessment or a penalty cannot be enhanced or the amount of refund cannot be reduced unless the appellant had a reasonable opportunity of showing cause against such enhancement or reduction.

6) **Imposition of penalty (Section 271):** The Commissioner (Appeals) may impose penalty for not producing the books of accounts or other
documents [Section 142(1)] or for concealment of income (under Section 271).

8.12 Return of Income [(Section 139(1)]

The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income. According to that section, it is statutorily obligatory for every person being a company or a firm or being a person other than a company or firm to furnish a return of his total income or the total income of any other person in respect of which he is assessable under the Income-tax Act, in all cases where his total income or the total income of any other person for which he is liable to be assessed exceeds, in any relevant accounting year, the maximum amount which is not chargeable to income-tax. The return of income must be furnished by the assessee in the prescribed manner by the Board from time to time.

It should be obligatory for the firm to file return of income in every case. Further, in respect of individual, HUF, AOP, BOI, Artificial juridical Person, filing of return of income shall be compulsory if their total income before allowing deductions under Sections 10A, 10B,10BA or chapter VI-A exceeds the maximum amount which is not chargeable to income tax.

8.13 Due date for filing return of income

The assessee is obliged to voluntarily file the return of income without waiting for the notice of the Assessing Officer calling for the filing of the return.

The time limit for filing of the return by an assessee if his total income of any other person in respect of which he is assessable exceeds the maximum amount not chargeable to tax, shall be as follows:

(a) where the assessee is—

(i) a company,

(ii) a person, other than a company whose accounts are required to be audited under the Income-tax Act or any other law, for the time being in force,

(iii) a working partner of a firm whose accounts are required to be audited under this Act or under any law for the time being in force,

the 30th day of September of the Assessment Year.

(b) In the case of an assessee being a company, which is required to furnish a report referred to in section 92E, the 30th day of November of the assessment year.

(c) in the case of any other assessee, the 31st day of July of the Assessment Year.
Test Your Knowledge

What is the due date for e-filing if the assessee is a Charitable Trust?

(a) 31st of March  
(b) 30th of September  
(c) 31st of July  
(d) 31st of December

Correct answer: (b) & (c)

The due date for the trust shall be 30th September if the income before claiming the exemption u/s 11 & 12 does not exceed the maximum amount not chargeable to tax. However if the charitable trust does not wish to take exemption then its accounts are not required to be audited, the due date shall be 31st July.

8.14 E-filing of Return

Filing of Income Tax Returns is a legal obligation of every person who total for the previous year exceeds the exemption limit provided under the Income Tax Act, 1961. The Income Tax Department has introduced online facility in addition to conventional method to file return of income. The process of electronically filing of Income Tax return through the mode of internet access is called e-filing of return. E-filing offers convenience of the tax payers. The only obligation for the user of this facility is to have a PAN number. There are eight forms from ITR-I to ITR-8 for e-filing of returns. There is a provision e-filing for digital signature by the assessee.

8.15 Bulk Filing of Return

Finance Act, 2002 has introduced a new scheme of Bulk Filing of Return vide new Section 139(1A). According to the new provisions, any person, being an individual who is in receipt of income chargeable under the head “Salaries” may, at his option, furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be specified by the Board in this behalf. The employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme, and in such case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under Section 139(1) and the provisions of this Act shall apply accordingly.

However, the following returns of employees cannot be submitted under the above schemes:

I. return of a year other than the current year;  
II. return without PAN;  
III. return under Block assessment;  
IV. return of an employee having more than one employer.

8.16 Power to Central Government:

Section 139(1C) empower the Central Government to exempt any class or classes
of persons from the requirement of furnishing a return of income by issue notification in the official Gazette.

8.17 Return of Loss - Section 139(3)

The requirements of Income-tax Act making it obligatory for the assessee to file a return of his total income apply equally even in cases where the assessee has incurred a loss under the head 'profits and gains from business or profession' or loss from maintenance of race horses or under the head 'Capital gains'. Unless the assessee files a return of loss in the manner and within the same time limits as required for a return of income, the assessee would not be entitled to carry forward the loss for being set off against income in the subsequent year.

8.18 Belated Return – Section 139(4)

Any person who has not filed the return within the time allowed under section 139(1) or within the time allowed under a notice issued by the Assessing Officer under section 142(1) may file a belated return

— at any time before the expiry of one year from the end of the relevant assessment year or

— before the completion of the assessment whichever is earlier.

Test Your Knowledge

For the previous year 2011-12, Mr. X did not file the return of income on the due date. Can Mr. X file the return of income after the due date?

Correct answer: Yes, As per section 139(4), Mr. X can file a belated return. Mr. X may file the return of income at any time on or before 31st of March 2014 (one year from the end of the Assessment Year 2012-13).

8.19 Return of Income of Charitable trust and Institutions – Section 139(4A)

Sub-section (4A) of Section 139 also makes it incumbent of -every person in receipt of income derived from property held under trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes or of income being voluntary contributions within the meaning of Section 2(24)(iia)” to furnish a return of income in case the total income exceeds the maximum amount not chargeable to tax.

Further, one who is assessable as a representative assessee for the receipt of income derived from property held under Trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes or of income being voluntary contributions shall furnish a return of income of the previous year in the prescribed form and get it verified in such manner as prescribed under Section 139(1), if the total income (without giving effect to the provisions of Sections 11 and 12) exceeds the amount not chargeable to tax.
8.20 Return of income of Political Party- Section 139(4B)

It is also incumbent on the political parties to file their return of income [if the income (without giving effect to the provisions of Section 13A) exceeds the maximum amount not chargeable to tax], duly signed by the Chief Executive Officer of the party.

8.21 Return of Income of Specified association/institutions- Section 139(4C)

Before introducing a new Section 139(4C) to the Act, there was an ambiguity about filing of return by certain categories of persons who are availing the exemption from income tax. Now this issue is solved with effect from assessment year 2003-04 and the following persons are required to file the return:

(a) Research association referred to in Section 10(21);
(b) news agency referred to in Section 10(22B);
(c) association or institution referred to in Section 10(23A);
(d) institution referred to in Section 10(23B);
(e) fund or institution referred to in Section 10(23C)(iv), (v), (vi) or (via);
(f) trade union referred to in Section 10(24)(a) or 10(24)(b),
(g) body or authority or Board or Trust or Commission in section 10(46)
(h) infrastructure debt fund referred to in section 10(47)

The above persons shall, if the total income, without giving effect to the provisions of Section 10, exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under Section 139(1)".

8.22 Revised Return- Section 139(5)

An assessee who is required to file a return of income is entitled to revise the return of income originally filed by him to make such amendments, additions or changes as may be found necessary by him. Such a revised return may be filed by the assessee at any time

— before the expiry of one year from the end of the relevant assessment year
— before the the completion of assessment

whichever is earlier.

8.23 Defective Return-Section 139(9)

If the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within 15 days from the date of such intimation or within such further period as may be allowed by the Assessing Officer on the request of the assessee. If the assessee fails to rectify the defect within the aforesaid period, the return shall be deemed to be invalid and further it shall be deemed that the assessee had failed to furnish the return. However, where the assesseerectifies the defect after the expiry of the aforesaid period but before the assessment is made, the Assessing Officer may condone the delay and treat the return as a valid return.

A return of income shall be regarded as a defective return unless all the following
conditions are fulfilled:

(a) the annexures, statements and columns in the return of income relating to computation of income chargeable under each head of income, computation of gross total income and total income have been duly filled in;

(b) the return is accompanied by a statement showing the computation of tax payable on the basis of return as well as the report of audit obtained under Section 4AB;

(c) the return is accompanied by proof of:

(i) the tax, if any, claimed to have deducted at source and the advance tax and tax on self-assessment, if any, claimed to have been paid;

(ii) the amount of compulsory deposit, if any, claimed to have been made (The scheme has been abolished w.e.f. 1.4.1985).

But a return shall not be called defective where it is not accompanied by proof of the tax, if any, claimed to have been deducted at source, if:

(a) a certificate for tax deducted was not furnished under Section 203 to the person furnishing his return of income;

(b) such certificate is produced within a period of two years specified under Sub-section (14) of Section 155".

(d) where the regular books of account are maintained by the assessee, the return is accompanied by copies of:

(i) manufacturing account, trading account, profit and loss account or income and expenditure account or any similar account and balance sheet;

(ii) in the case of proprietary business or profession, the personal account of the proprietor; in the case of a firm, association of persons or body of individuals, personal accounts of the partners or members; and in the case of a partner or member of a firm, association of persons or body of individuals, also his personal account in the firm, association of persons or body of individuals.

(e) where the accounts of the assessee have been audited, the return is accompanied by copies of the audited profit and loss account and balance sheet and auditors’ report; and where an audit of cost accounts of the assessee has been conducted under Section 233B of the Companies Act, 1956 also the report under that section.

(f) where regular accounts are not maintained by the assessee, the return is accompanied by a statement indicating the amounts of turnover or gross receipts, gross profit, expenses and net profit of the business or profession and the basis of which such amounts have been computed, and also disclosing the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

Note: Not relevant now as the assessee has to furnish annexure less return of income from assessment year 2007-08 and onwards.
Test Your Knowledge

What is the time limit for filing revised return at present?

(a) Within the assessment year
(b) Before the expiry of one year from the end of the relevant assessment year
(c) Before the expiry of two years from the end of the relevant assessment year
(d) Before the completion of assessment even if it takes more than one year from the end of the relevant assessment year

Correct Answer: (b)

New return forms

<table>
<thead>
<tr>
<th>ITR Forms</th>
<th>Subject</th>
</tr>
</thead>
<tbody>
<tr>
<td>ITR 1 (SAHAJ)</td>
<td>For individual having income from salary and interest.</td>
</tr>
<tr>
<td>ITR 2</td>
<td>For individuals and HUFs not having business/professional income.</td>
</tr>
<tr>
<td>ITR 3</td>
<td>For individuals/HUFs being partners in firms and not carrying out business or profession under any proprietorship.</td>
</tr>
<tr>
<td>ITR 4</td>
<td>For individuals and HUFs having income from proprietary business or profession.</td>
</tr>
<tr>
<td>ITR-4S (SUGAM)</td>
<td>For Individuals/HUFs having income from presumptive business.</td>
</tr>
<tr>
<td>ITR 5</td>
<td>For Firms, AOP and BOI.</td>
</tr>
<tr>
<td>ITR 6</td>
<td>For companies other than companies claiming exemption under Section 11.</td>
</tr>
<tr>
<td>ITR 7</td>
<td>For persons including companies required to furnish return under Section 139(4A)/139(4B)/139(4C)/139(4D). (not opting for e-filing)</td>
</tr>
</tbody>
</table>

Acknowledgement (ITRV)

Where the data of the return of income/Fringe benefits in Forms ITR-1, ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 & ITR-8 transmitted electronically without digital signature.

8.24 New scheme to facilitate submission of returns through Tax return preparers [Section 139B] [w.e.f. 1-6-2006]

W.e.f. 1.6.2006, a new section 139B have been inserted in the Act so as to provide that for the purpose of enabling any specified class or classes of persons to prepare and furnish returns of income, the Board may, by way of notification, frame a scheme providing that such persons may furnish their returns of income through a
Tax return preparer authorized to act as such under the scheme. This scheme is not applicable for a company or a person who is required to undergo a ‘tax audit’ or ‘audit under any other law’.

It has been further provided that the Scheme framed under the said section shall specify the manner in which the Tax return preparer shall assist the persons furnishing the return of income, and shall also affix his signature on such return.

A Tax return preparer may be an individual other than a person referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (2) of section 288 or an employee of the specified class or classes of persons, who has been authorized to act as a Tax return preparer under this Scheme.

**In other words, the following persons are not authorized to act as Tax return preparer:**
- any officer of a scheduled bank in which the assessee maintains a current account or has regular dealings.
- A legal practitioner; or
- A chartered accountant.

The Scheme notified under the said section shall provide the manner in which a Tax return preparer shall be authorized, the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax return preparer, the code of conduct for the Tax return preparer, the duties and obligations of the Tax return preparer, the manner in which the authorization may be withdrawn and any other matter which is required to be or may be specified.

**8.25 Signing of Return (Section 140)**

The return of income must be signed and verified:

(a) **In the case of an individual,**
   (i) by the individual himself;
   (ii) where he is absent from India, by the individual himself or by some person duly authorised by him in this behalf;
   (iii) where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf; and
   (iv) where, for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf:

Provided that in a case referred to in Sub-clause (ii) or (iv), the person signing the return holds a valid power of attorney from the individual to do so, which shall be attached to the return:

(b) **in the case of a H.U.F. by the Karta,** and, where the karta is absent from India or mentally incapacitated from attending to his affairs, by any other adult member of such family;

(c) **in the case of a local authority,** the Principal Officer thereof;
(d) in the case of a firm, by managing partner thereof or where for any unavoidable circumstances such managing partner is not able to sign and verify the return, or where there is no managing partner as such, by any partner thereof, not being a minor;

(e) in the case of a limited liability partnership, by the designated partner thereof, or where for any unavoidable reason such designated partner is not able to sign and verify the return, or where there is no designated partner as such, by any partner.

(f) in the case of any other association, by any member of the association or Principal Officer thereof;

(g) in the case of any other person, by that person or some person competent to act on his behalf;

(h) in the case of a company; by the managing director thereof, or where for any unavoidable reason such managing director is not able to sign the return or where there is no managing director, by any director thereof.

Provided that where the company is not resident in India, the return may be signed and verified by a person who holds a valid power of attorney from such company to do so, which shall be attached to the return:

Provided further that —

(a) where the company is being wound up, whether under the order of a court or otherwise, or where any person has been appointed as the receiver of any assets of the company, the return shall be signed and verified by the liquidator referred to in Sub-section (1) of Section 178;

(b) where the management of the company has been taken over by the Central Government or any State Government under any law, the return of the company shall be signed and verified by the Principal Officer thereof;

(i) in the case of a political party referred to in Sub-section (4B) of Section 139, by the Chief Executive Officer of such party whether such Chief Executive Officer is known as secretary or by any other designation.

8.26 Permanent Account Number (Section 139A)

Every person, who has not been allotted any permanent account number, is obliged to obtain permanent account number, if;

— if his total income assessable during the previous year exceeds the maximum amount which is not chargeable to tax or

— any person carrying on business or profession whose total sales turnover or gross receipts are or is likely to exceed ₹5,00,000 in any previous year or

— is required to furnish a return of income under Section 139(4A)

Besides above cases, the Assessing Officer may also allot a permanent account number to any other person by whom tax is payable. Any other person may also apply
for a permanent account number. However, Section 139 has been amended w.e.f. August 1, 1998 and provides the alternative of quoting GIR (General Index Register) number till such time the permanent account number is allotted.

**Power delegated to Central Government:**

The Central Government may, by notification in the Official Gazette, specify, any class or classes of persons by whom tax is payable under this Act or any tax or duty is payable under any other law for the time being in force including importers and exporters whether any tax is payable by them or not and such persons shall, within such time as mentioned in that notification, apply to the Assessing Officer for the allotment of a permanent account number.

**8.27 Quoting of PAN:**

It shall be the duty of every person who has been allotted permanent account number to quote such number in all his returns or correspondence with Income tax authorities, quote such numbers in all challans for the payment of any sum, quote such number in all documents pertaining to such transactions as may be prescribed by the Board in the interest of revenue.

Now quoting PAN is compulsory in the following transactions:

(a) Sale/purchase of any immovable property valued at ₹ 5 lakhs or more.
(b) Sale/Purchase of Motor vehicle or a vehicle (excluding two wheeled vehicle, inclusive of any detachable side-car having an extra wheel) which requires registration under Motor Vehicles Act, 1988.
(c) Time deposit exceeding ₹ 50,000 with a Bank/Banking Company/Banking Institution.
(d) Deposit exceeding ₹ 50,000 in Post Office Savings Bank.
(e) Contract for sale/purchase of securities exceeding ₹ 10 lakhs.
(f) Opening an account [not being time deposit mentioned in (c)] with a Bank/Banking Company/Banking Institution.
(g) Application for installation of a telephone connection including mobile phone.
(h) Payments to hotels of bills exceeding ₹ 25,000/- at any one time.

Every person, receiving any document relating to the prescribed transactions, shall ensure that the permanent account number has been duly quoted in the document. The Board has been empowered to make rules in relation to the form and the manner in which the application for the allotment of a permanent account number and the particulars which such application will contain, prescribing the categories of transactions and the categories of documents pertaining to business or profession in which the permanent account numbers shall have to be quoted by every person.

The “permanent account number under the new series” has been defined to mean a number which will have ten alphanumeric characters to be issued on a laminated card.

The expression “Assessing Officer” has been defined to include an income tax authority to whom the job of allotting permanent account numbers has been assigned.
8.28 Types of Assessment:

(a) Self assessment (Section 140A)
(b) Regular assessment (Section 143)
(c) Best judgement assessment (Section 144)
(d) Income escaping assessment or re-assessment (Section 147)
(e) Precautionary assessment.

(a) Self Assessment (section 140A):

Self assessment is the first step in the process of assessments. Self Assessment is simply a process where a person himself assesses his tax liability on the income earned during the particular previous year and submits Income Tax Return to the department. Every person, before furnishing return under sections 139 (return of income), 142(1), 148 (issue of notice where income has escaped assessment) and 153A (Assessment in case of search or requisition) shall make self assessment of his income and pay the tax, if due on the basis of such assessment. The total tax payable is calculated on the total income of the assessee after considering the following amount:

(i) the amount of tax already paid under any provision of this Act;
(ii) any tax deducted or collected at source;
(iii) any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India;
(iv) any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section; and
(v) any tax credit claimed to be set off in accordance with the provisions of section 115JAA.

Such determined value of tax along with the interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax is paid before furnishing the return and the proof of payment of such tax is attached with the return.

The work of income tax department became easy due to the system of Self Assessment.

Inquiry before assessment under section 142 or 142A:

1. Issue of notice to the assessee to submit return (if not submitted earlier):
The existing provisions contained in section 142(1)(i), inter alia, provide that for the purpose of making assessment in a case where a person has not made a return of his income within the time specified under sub-section (1) of section 139, the Assessing Officer may serve a notice under sub-section on such a person requiring him to furnish the return of his income in the prescribed form and manner.
Clause (i) of sub-section (1) has been amended so as to provide that in a case where a person has not made a return of his income before the end of the relevant assessment year, the Assessing Officer may serve a notice after the end of the relevant assessment year under said sub-section requiring such person to furnish his return of income.

The Assessing Officer may ask to produce, or cause to be produced, such accounts or documents and to furnish in writing and verified in the prescribed manner information in such form and on such points or matters (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not). However, the previous approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts. Further, the Assessing Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

2. Make Inquiry and give opportunity of being heard u/s 142(2):

For the purpose of obtaining full information in respect of the income or loss of any person, the Assessing Officer may make such inquiry as he considers necessary

3. Give direction to get books of accounts audited u/s 142(2A) to (2D):

Having regard to the nature and complexity of the accounts of the assessee and the interests of the revenue, assessing officer is of the opinion that it is necessary to order audit then with the previous approval of the Chief Commissioner or Commissioner the Assessing Officer may direct an assessee to get his accounts audited by an accountant even if the accounts have earlier been audited.

The Assessing Officer shall not direct the assessee to get the accounts audited unless the assessee has been given a reasonable opportunity of being heard.

Every report under sub-section (2A) shall be furnished by the assessee to the Assessing Officer within the period as specified by the Assessing Officer.

However, the Assessing Officer may, suo motu, or on an application made in this behalf by the assessee and for any good and sufficient reason, extend the said period by such further period or periods as he thinks fit but shall not exceed 180 days from the date on which the direction under sub-section (2A) is received by the assessee.

The expenses of, and incidental to, such audit (including the remuneration of the Accountant) shall be determined by the Chief Commissioner or Commissioner in accordance with such guidelines as may be prescribed and the expenses so determined shall be paid by the Central Government.

Summary assessment/Intimation to the assessee u/s 143(1)

Under summary assessment, Assessing Officer completes the assessment without passing a regular assessment order. The Assessing Officer issue an acknowledgement/intimation under section 143(1) of tax payable or refundable as the case may be on the basis of Return of Income filed by the assessee under section 139 or in response to a notice issued under section 142(1). The Assessing Officer
(AO) processes the return in the following manner:

1. The total income or loss after making adjustments for any arithmetical error in the return or for any incorrect claim which is apparent from any information in the return is calculated.

2. Then the tax and interest, if any, on the basis of the total income computed in step (1) is computed.

3. Now following adjustments are made to the tax and interest calculated above to determine the sum payable by the assessee or any amount of refund due to him:
   - tax deducted at source,
   - any tax collected at source,
   - any advance tax paid,
   - any relief allowable under an agreement under section 90, 90A and 91,
   - any rebate allowable under Part A of Chapter VIII,
   - any tax paid on self-assessment and
   - any amount paid otherwise by way of tax or interest;

4. The AO shall prepare or generate intimation and send it to the assessee specifying the sum determined to be payable by, or the amount of refund due to the assessee.

5. The amount of refund due to the assessee shall be granted to the assessee.

Since no assessment order is issued by the department for legal purposes the intimation/acknowledgement shall not be considered as assessment.

**Time limit for intimation under section 143(1):**

No intimation for tax or interest due under section 143(1) shall be sent after the expiry of 1 year from the end of financial year in which return of income is made.

### Example:

For the assessment year 2012-13, Mr. Rajan files the ITR on 25th July 2012. Intimation under section 143(1) may be sent up to 31st March 2014.

(b) Scrutiny(Regular) Assessment [Section 143(2) & (3)]

Where a return has been made under Section 139, or in response to a notice under Sub-section (1) of Section 142, the Assessing Officer shall, if he considers necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return:

Provided that no notice under this sub-section shall be served on the assessee after the expiry of six months from the end of the Financial year in which the return is furnished.
On the day specified in the notice issued under Sub-section (2), or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.

(c) Best Judgement Assessment u/s 144:

The Assessing Officer, after taking into account all relevant material which he has gathered, and after giving the assessee an opportunity of being heard, makes the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment in the following cases:

- If any person fails to make the return required under section 139(1) and has not made a return or a revised return under section 139(4) or 139(5), or
- When a person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited, or
- If any person having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Prior to the proceedings the AO should issue a show cause notice to the assessee. However if the assessee has already issued notice under section 142(1)(i) and the assessee has not complied with the terms then AO can proceed further without issuing a show cause notice.

Further AO cannot assess the income below returned income and cannot assess losses higher than the returned losses. A refund cannot be granted under section 144.

The assessing officer can also reject the accounts book under section 145 and can make best judgment assessment under section 144 if:

- The accounts books are incorrect, false or incomplete.
- If the accounting method employed is such that the profit cannot be derived from it correctly.
- Where the method of accounting adopted by the assessee is not followed by him regularly.
- If the assessee has not followed the accounting standards notified by the government.

(d) Income escaping Assessment or Re-assessment (section 147)

If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153,

- assess or reassess income which has escaped assessment or
- recompute the loss or the depreciation allowance or any other allowance, as the case may be for the relevant assessment year.
Section 147, the Assessing Officer shall serve on the assessee a *notice requiring him to furnish, within such period, as may be specified in the notice, a return of his income or the income of any other person in respect of which he is assessable under this Act during the previous year corresponding to the relevant assessment year, in the prescribed form, and verified in the prescribed manner and setting forth such other particulars, as may be prescribed; and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return furnished as per the requirements of Section 139.

Provided that in a case—

(a) where a return has been furnished during the period commencing on the 1st day of October, 1991 and ending on the 30th day of September, 2005 in response to a notice served under this section, and

(b) subsequently a notice has been served under Sub-section (2) of Section 143 after the expiry of twelve months specified in the proviso to Sub-section (2) of Section 143, as it stood immediately before the expiry of the time limit for making the assessment, reassessment or recomputation as specified in sub-section (2) of Section 153, every such notice referred to in this clause shall be deemed to be a valid notice.

The assessing officer before making the assessment under this section will have to issue notice u/s 148 to the assessee requiring him to file the return even if he has already filed the return under section 139 or 142(1). The AO is duty bound to provide the assessee the reasons recorded by him, if the assessee request for it. If on request the reasons are not supplied then AO cannot proceed the assessment. The time limit for issue of notice under section 148 is as under:

<table>
<thead>
<tr>
<th>Cases</th>
<th>Upto 4 years from the end of relevant assessment year</th>
<th>Beyond 4 years but upto 6 years from the end of the relevant assessment year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where assessment order passed u/s 143(3) or 147.</td>
<td>(i) Notice can be issued for any amount of escaped income. (ii) Notice can be issued by Assistant Commissioner or Deputy Commissioner and by AO with the approval of Joint Commissioner.</td>
<td>(i) Notice can be issued only if escaped income is of ₹100,000 or more. (ii) Notice can be issued by the AO only with the approval of Chief Commissioner or Commissioner.</td>
</tr>
<tr>
<td>Where no assessment order has been passed u/s 143(3) or 147.</td>
<td>Notice can be issued by AO whatever be the amount.</td>
<td>Notice can be issued by the AO only with the approval of Joint Commissioner only when the amount is likely to be ₹100,000 or more for that year.</td>
</tr>
</tbody>
</table>

* Sub-section (2) inserted in this section by the Direct Tax Laws (Amendment) Act, 1989 to provide that the Assessing Officer shall, before issuing any notice under Section 148, record his reasons for doing so.
Time limit for completion of Assessments:

Section 153 of the Act prescribes time limit for completion of various assessments which is described as below:

<table>
<thead>
<tr>
<th>Assessment u/s 143/144</th>
<th>21 months from the end relevant assessment year in which the income was first assessable.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income escaping assessment u/s 147</td>
<td>9 months from the end of financial year in which the notice u/s 148 was served on the assessee.</td>
</tr>
</tbody>
</table>

Computation of Period of limitation:

In computing the period of limitation for this purpose, the time taken in the following cases shall be excluded:

(i) the time taken in re-opening the whole or part of the proceeding or in giving an opportunity to the assessee to be re-heard under Section 129;

(ii) the period during which the assessment proceeding is stayed by an order or injunction of any court;

(iii) the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A) and ending with the date on which the assessee furnishes a report of such audit;

(iv) the period (not exceeding 60 days) commencing from the date on which the declaration under Section 158A(1) is received by the Assessing Officer and ending with the date on which the order thereunder is made by him;

(v) where an application made before the Income-tax Settlement Commission is rejected by it, the period commencing from the date on which application is made and ending with the date on which the order is received by the Chief Commissioner or Commissioner.

(vi) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) of section 245Q and ending with the date on which the order rejecting the application is received by the Commissioner under sub-section (3) of section 245R, or

(vii) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) of section 245Q and ending with the date on which the advance ruling pronounced by it is received by the Commissioner under sub-section (7) of section 245R,

(viii) the period commencing from the date on which reference for the exchange of information is made by the authority competent under the agreement referred to in section 90 or section 90A and ending with the date on which the information so requested is received by the commissioner or the period of six months whichever is less.
(e) Precautionary Assessment:

Where it is not clear as to who has received the income and prima facie, it appears that the income may have been received either by A or by B or by both together, the Assessing Officer can commence proceedings against both A and B to determine the question as to who is responsible to pay the tax [Lalji Haridas v. I.T.O. (1961) 43 ITR p. 387 (S.C.)].

8.29 Reference to dispute resolution panel (Section 144C)

The Assessing Officer shall, forward a draft order of assessment to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order.

(a) file his acceptance to the Assessing Officer, or

(b) file his objections with
   (i) the Dispute Resolution Panel; and
   (ii) the Assessing Officer

The Assessing Officer shall complete the assessment on the basis of the draft order, if the assessee intimates to the Assessing Officer the acceptance of the variation or no objections are received.

The Assessing Officer shall, notwithstanding anything contained in section 153, pass the assessment order under sub-section (3) within one month from the end of the month in which the acceptance is received or the period of filing of objections expires.

The Dispute Resolution Panel shall, in a case where any objection is received, issue such directions for the guidance of the Assessing Officer to enable him to complete the assessment.

The Dispute Resolution Panel shall issue the directions after considering draft order, objections filed by the assessee, evidence furnished by the assessee, report of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority, records relating to the draft order, evidence collected by it and result of any enquiry made by it.

The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order however it shall not set aside any proposed variation or issue any direction for further enquiry and passing of the assessment order.

If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

No direction shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue.
No direction shall be issued after nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

Upon receipt of the directions the Assessing Officer shall complete, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received.

1. “Dispute Resolution Panel” means a collegium comprising of three Commissioners of Income-tax constituted by the Board for this purpose;
2. “eligible assessee” means
   (i) any person in which case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 93CA; and
   (ii) any foreign company.

8.30 RECTIFICATION OF MISTAKES [Section 154]

With a view to rectifying any mistakes apparent from the record, an income-tax authority referred to in Section 116 may amend
— any order passed by it under provisions of this Act or
— any intimation or deemed intimation under Section 143(1).

This power of rectification can be exercised by the authorities either on their own motion or at the instance of the assessee.

Mistake which can be rectified: The mistake sought to be rectified may be a mistake of fact or of law. But the mistake must be one which is glaring, obvious or apparent from the records and should not be one to discover which a long drawn process of reasoning, arguments, etc., are needed, or for which there may be conceivably two opinions. A decision on debatable point of law is not a mistake apparent from the record [T.S. Balram v. Volkart Bros. (1971) 82 ITR p. 50 (S.C.)]. However, ‘the record’ contemplated under Section 154 does not mean only the order of assessment but it comprises all proceedings on which the assessment order is based. The relevant authority is entitled to look into the whole evidence and the law applicable to ascertain whether there was an error [Moharana Mills Pvt. Ltd. v. ITO (1959) 36 ITR p. 350 (S.C.)].

The power of rectification of mistake lies with the authority who passed the order which is sought to be rectified. For instance, the Assessing Officer may amend any order of assessment or refund or any other order passed by him. Likewise, the Deputy Commissioner or Commissioner (Appeals) or the Chief Commissioner or Commissioner may rectify any order passed by him.

Where an order of rectification of assessment has the effect of enhancing the amount of income assessed or reducing a refund granted to the assessee or in any way otherwise increasing the liability of the assessee, the order of rectification can be passed only after giving the assessee a notice in advance and, that too, after giving him a reasonable opportunity of being heard.

Every order of rectification of assessment must be passed by the authority concerned in writing and should specifically state how and in what respects the
assessment had been rectified. Where any amendment has the effect of enhancing the assessment or reducing the refund already made, the Assessing Officer shall serve on the assessee a notice of demand in the prescribed manner specifying the amount of tax, interest or other sum payable by him.

**Time limit**

The time limit for rectification of mistakes is a period of four years from the end of the financial year in which the order sought to be amended was passed.

where an application for an amendment under this section is made by the assessee on or after the 1st day of June, 2001 to an Income-tax authority referred to in Sub-section (1), the authority shall pass an order, within a period of six months from the end of the month in which the application is received by it:

— by making the amendment; or

— refusing to allow the claim.

---

**LESSON ROUND UP**

- At first in this chapter the Income Tax authorities : their appointment; jurisdictions and powers; is discussed.
- Filing of return under Sectin 139 of the Income Tax Act, types of assessment and other issues relating to assessment and re-assessment of income is being discussed.
- Regarding various procedures under which an assessee can assess his income for the relevant previous year either under self-assessment procedure or regular assessment procedure or best judgement assessment procedure or income escaping assessment procedure or precautionary assessment procedure is being discussed in this chapter.

---

**SELF TEST QUESTIONS**

1. State the income-tax authorities who are empowered to administer the Income-tax Act and explain their powers, functions and jurisdiction in relation to assessment of income.
2. Discuss the statutory obligations of an assessee to file a return of his income and indicate the time-limits for filing the return.

3. Explain the following:
   (a) Return of loss; (b) Belated return; (c) Revised return; and (d) Voluntary return.

4. What is self-assessment? What are the consequences of non-payment of tax on "Self-assessment"?

5. Discuss how regular assessments and best judgement assessments are made under the Act?

6. Under what circumstances is the Assessing Officer empowered to reopen the assessment made by him? Give example.

7. Explain the circumstances under which income is said to have escaped assessment and state the power of the Assessing Officer to assess such escaped income. Illustrate.

8. Specify the time limits within which -
   (a) notice should be issued by the Assessing Officer for making an assessment or re-assessment;
   (b) the assessment or re-assessment should be completed.

9. What is a mistake apparent from the record? Explain the specific cases of mistakes given in the Act which are to be rectified and state the time limits for rectification in each case.

10. Explain the provisions of the Act regarding advance payment of income-tax.

11. Explain the provisions of the Act regarding tax deduction at source on the following income:
   (a) Salaries
   (b) Dividends
   (c) Payments to Contractors.

12. Under what circumstances is an assessee entitled to refund? Explain the procedure for claiming a refund.

13. Write a lucid note on best judgement assessment with suitable illustration.
Once the tax is being collected either by others, it is their duty to deposit the same to the credit of the Central Government under prescribed procedures stated under the Income Tax Act, 1961. Here the question of TDS arises and in this chapter this aspects of the Income Tax Act has been elaborately discussed with special emphasis on e-TDS and other relevant issues.

LEARNING OBJECTIVES

The objective of this chapter is to discuss the following topics/concepts:

- Collection and Recovery of Tax
- Payment of Income-Tax
  (a) Deduction of Tax at Source
    Consequence in the event of default (Section 201)
    e-TDS Return : 
  (b) Advance Payment of Tax
    Due Dates and Instalments of Advance Tax
- Refunds (Sections 237 to 245)
- Whom to apply for refund?
- For failure to deduct and pay tax at source [Section 201]
- For belated payment of Income-tax [Section 220(2)]
- Interest for default in furnishing Return of Income(Section 234A)
- Interest for default in payment of Advance Tax (Section 234B)
- Interest for deferment of Advance Tax (Section 234C)
- Interest Receivable by the Assessee
- Section 244A (Interest on refunds)

9.1 COLLECTION AND RECOVERY OF TAX

(a) Notice of Demand (Section 156) (Rules 15, 38, Forms 7, 28)

When any tax, interest penalty, fine or any other sum is payable in consequence of any order passed under this Act, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable.
(b) Intimation of loss (Section 157)

When in the course of the assessment of the total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set off against the income in subsequent years, the Assessing Officer shall notify to the assessee by an order in writing the amount of the loss as computed by him for the purposes of carry forward and set off.

(c) Assessee in Default:

The amount specified in the notice of demand shall be paid within 30 days of the service of the notice at the place and to the person mentioned in the notice. If the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of 30 days is allowed he may, with the prior approval of the Joint Commissioner reduce the period as he thinks fit (Section 220).

If the amount specified in the notice of demand is not paid within the period mentioned in the notice, the assessee shall be liable to pay simple interest at one and one-fourth per cent for every month or part of a month comprised in the period commencing from the day immediately following the end of the 30 days or shorter period, as allowed, and ending with the date of payment of the tax. If the assessee is not in a position to pay the amount in the prescribed time, he may submit an application to the Assessing Officer before the expiry of the due date of the payment. On receipt of such application, the Assessing Officer may extend the time for payment or allow payment by instalments, subject to such conditions as he may think fit to impose. If the amount is not paid as mentioned above, the assessee shall be deemed to be in default and shall be liable to pay in addition to the amount of the arrears and the amount of interest, by way of penalty such amount as the Assessing Officer may direct. In the case of continuing default, he shall be liable to pay such further amount as the Assessing Officer may, from time to time, direct. However, the total amount of penalty shall not exceed the amount of tax in arrears.

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in the prescribed form specifying the amount of arrears due from the assessee and shall proceed to recover from such assessee the amount specified in the certificate (being the statement referred to above) by one or more of the modes mentioned below, in accordance with the rules laid down in the Second Schedule.

(A) (i) attachment and sale of the assessee’s movable or immovable property;
    (ii) arrest of the assessee and his detention in prison; and
    (iii) appointing a receiver for the management of the assessee’s movable and immovable properties (Section 222).

(B) The Assessing Officer may also recover the tax by any one or more of the following modes of recovery:
    (i) attachment of salary;
    (ii) garnishee order;
    (iii) from a court;
    (iv) sale of movable property (Section 226);
(C) Through State Government (Section 227);
(D) In pursuance of agreement with foreign countries (Section 228A);
(E) By suit or under other law (Section 232).

Note: For details please refer to the relevant sections of the Act.

9.2 PAYMENT OF INCOME-TAX

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

(i) deduction of tax at source in respect of income by way of salaries, interest on securities, interest other than interest on securities, winnings from lotteries and crossword puzzles, winnings from horse-race, insurance commission, dividends, payment to contractors or subcontractors and payments to non-residents;

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

(iii) direct payment of income-tax by the assessee on self-assessment; and

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

The provisions relating to payment of tax on self-assessment and subsequent to the regular assessment have already been discussed in this Study Paper. The provisions relating to tax deduction at source and payment of tax in advance of assessment are being discussed below:

(a) Deduction of Tax at Source

Sections 192 to 206 of the Income-tax Act lay down the provisions relating to deduction of tax at source. The provisions in respect of different incomes are as follows:

(1) Salary (Section 192)

(i) Any person responsible for paying any income (employer) chargeable under the head “Salaries” shall, at the time of payment, deduct income-tax on the amount payable at the rates applicable to the estimated income of the assessee (employee) under this head for that financial year. It is not the total income that is subject to deduction of tax at source but the estimated income under the head “Salaries” that is important. W.e.f. August 1, 1998, an assessee having an income under the head ‘salaries’ may furnish in the prescribed manner giving the details of the losses under the head ‘Income from House Property’ to the person responsible for making the payment who shall taking into account such loss for the purposes of computing the tax deductible from salaries, which may be reduced in such a case.

Only where the loss under the head “Income from House Property” has been taken into account TDS deductible from the head salaries may be reduced due to such loss taken into account. For this purpose the salary shall be computed in the same manner as discussed under the head ‘Salaries’. From such salary the following deductions shall be made:

(a) amount deductible Sections 80C, 80D, 80DD and 80DDB.
(b) deduction under Section 80G, in respect of donations made to the National Defence Fund, Jawahar Lal Nehru Memorial Fund, the Prime Minister's Drought Relief Fund etc. subject to conditions laid down under Section 80G;

(c) deduction under Section 80GG in respect of rent paid;

(d) deduction under Section 80RRA in respect of remuneration received in foreign currency;

(e) deduction under Section 80U on production of a certificate by the employee from the Assessing Officer authorising such deduction. Certificate need not be produced by individuals who have already produced a certificate under the old provision applicable upto 1991-92 assessment year.

(ii) The employer may, at the time of making any deduction, increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of any previous deductions or failure to deduct during the financial year.

(iii) The trustees of a recognised provident fund or an approved superannuation fund shall deduct the tax at the time of the accumulated balance due to an employee is paid provided it is not exempted.

<table>
<thead>
<tr>
<th>No tax will be required to deducted at source in case the estimated salary income does not exceeds</th>
</tr>
</thead>
<tbody>
<tr>
<td>₹ 1,90,000 in case of resident women in India below 65 years of age at any time during the previous year.</td>
</tr>
<tr>
<td>₹ 1,80,000 in case of individual below 65 years of age.</td>
</tr>
<tr>
<td>₹ 2,50,000 in case of individual having the age of 65 years but below 80 years</td>
</tr>
<tr>
<td>₹ 5,00,000 in case of individual having the age of 80 years and above.</td>
</tr>
</tbody>
</table>

Where the salary is payable to an assessee outside India in foreign currency its value in rupees shall be the telegraphic transfer buying rate of such currency as on the date on which the tax is required to be deducted at source. 'Telegraphic transfer buying rate' means the rate of exchange adopted by the State Bank of India for buying such currency as made available to the bank through a telegraphic transfer.

The tax deducted at source must be paid to the credit of the Central Government through the prescribed Challan (No. 9 with “Blue colour band”) within 7 days of the deduction.

Every employer shall file a quarterly return in Form No. 24Q within 15 days from end of quarter and for the quarter ending on 31st March will be submitted on 31st May following the close of the relevant financial year showing:

(a) the name and address of every employee who is drawing such amount as may be prescribed;

(b) the amount of income so received by or so due to each such person; and

(c) the amount of tax deducted and deposited from the income of such person.
The employer shall issue a certificate of deduction of tax to the employee in Form No. 16.

Also, a person responsible for paying any income chargeable under the head “Salaries” is required to furnish, to the person to whom such payment is made, a statement giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof in such form and manner as may be prescribed.

(2) Interest on Securities (Section 193)

The person responsible for paying to a resident any income by way of interest on securities shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier deduct income-tax at the rates in force on the amount of the interest payable.

Credit of any income by way of interest on securities to any account, whether called “Interest payable account” or “Suspense account” or by any other name in the books of account of the person liable to pay such income, is, for the purposes of Section 193, deemed to be credit of such income to the payee and attracts applicability of the provisions of Section 193.

However, tax shall not be deducted from the interest on the following securities:

(i) 4-1/4% National Defence Bonds, 1972 held by a resident individual.
(iii) 7 year National Savings Certificates IV Issue.
(iv) Debentures issued by Co-operative Society (including Co-operative Land Mortgage Banks or Co-operative Land Development Banks) or any other institution or authority as the Central Government may specify in the Official Gazette.
(v) Gold bonds provided the assessee is a resident individual and the nominal value of the bonds did not exceed ₹ 10,000 at any time during the period to which the interest relates.
(vi) Securities of the Central Government or State Government.
(vii) Any interest payable to an individual, who is resident in India, on debentures issued by a company in which the public are substantially interested, being debentures listed on a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956, and any rules made thereunder if:
   (a) the interest is paid by the company by an account payee cheque, and
   (b) the amount of such interest or, as the case may be, the aggregate of the amounts of such interest paid or likely to be paid during the financial year by the company to such individual does not exceed two thousand five hundred rupees.
(viii) Interest on such Debentures as are issued by a statutory corporation or a Government company.
(ix) Interest payable to the Life Insurance Corporation of India established under the Life Insurance Corporation Act, in respect of any securities owned by it or in which it has full beneficial interest; or

(x) any interest payable to the General Insurance Corporation of India (hereafter in this clause referred to as the Corporation) or to any of the four companies (hereafter in this clause referred to as such company), formed by virtue of the schemes framed under Sub-section (1) of Section 16 of the General Insurance Business (Nationalization) Act, 1972 (57 of 1972), in respect of any securities owned by the Corporation or such company or in which the Corporation or such company has full beneficial interest; or

(xi) any interest payable on any other insurer in respect of any securities owned by it or in which it has full beneficial interest."

TDS can be made at the time of payment or at the time of credit to the account of the payee or transfer to interest payable amount or suspense account, whichever comes earlier. The identity of the person in whose hand it is includible have to be identified. Case law: [IDBI v. ITO (2006) 10 SOT 497/104 TTD 230 (Mum.)].

**Rate of TDS:**

The rate of TDS on Interest on securities is 10%. No education cess and SHEC shall be added to the rate. The rate of TDS shall be 20% if PAN is not quoted by the payee.

(3) **Dividends (Section 194)**

The principal officer of an Indian company or a company which has made prescribed arrangements for the declaration and payments of dividends within India shall deduct, from the amount of dividend [Dividend under Section 2(22)(a) to (d) payable on or after 1.6.2002] or deemed dividend under Section 2(22)(e), before making any payment in cash or before issuing cheque, income-tax at the prescribed rates.

No such deduction shall be made in the case of shareholder (being an individual, who is resident in India), of a company in which the public are substantially interested, if:

(a) the dividend is paid by such company by an account payee cheque; and

(b) the amount of such dividend or, as the case may be, the aggregate of the amounts of such dividend distributed or paid or likely to be distributed or paid during the financial year by the company to the shareholder does not exceed rupees two thousand five hundred.

No such deduction shall be made in respect of any dividends referred to in Section 115-O except where the dividend is covered under section 2(22)(e).

The provisions of Section 194 were amended by the Finance (No. 2) Act 1991 with effect from 1.10.1991 to provide specifically that no TDS shall be deducted on the distribution or payment of dividends to the shareholders who are resident in India.
(4) Interest other than Interest on Securities (Section 194A)

Any person not being an individual or a H.U.F. who is responsible for paying to a resident any income by way of interest other than income by way of interest on securities amounting to more than rupees 5,000 or ₹10,000 as the case may be, shall, at the time of crediting to the payee or at the time of payment or the interest, deduct tax at the prescribed rates.

**Rate of Tax:**

(i) 10% plus education cess. No surcharge, education cess or SHEC shall be added from 1st October, 2009.

(ii) When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

However, the tax shall not be deducted in the following cases:

(i) Where the payee is a banking Company, a co-operative society engaged in carrying on the business of banking or any deposit with post office under any scheme framed by the Central Government and notified by it in this behalf, and the aggregate amount of interest credited or paid during the financial year does not exceed ₹ 10,000.

(ii) Where the payee is other than the (i) above and the aggregate amount of interest paid or credited does not exceed ₹5,000.

(iii) Where the interest credited or paid to a banking company, a co-operative society doing banking business, Financial Corporation established by a Central or State Act, the Life Insurance Corporation of India, the Unit Trust of India, any company or co-operative society carrying on the insurance business and any other institution which the Central Government may notify in this behalf.

(iv) Interest credited or paid by a firm to its partners.

(v) Interest credited or paid by a co-operative society to its members or to any other co-operative society.

(vi) Where interest credited or paid in respect of deposits under any scheme framed by Central Government.

(vii) Interest credited or paid in respect of deposits other than time deposits with a banking company to which the Banking Regulation Act, 1949 applies.

(viii) Income credited or paid in respect of deposits with a primary agricultural credit society or cooperative society engaged in carrying on the business of banking including a cooperative land mortgage bank or a cooperative land development bank.

income which is paid or payable by an infrastructure capital company or infrastructure capital fund or a public sector company in relation to a zero coupon bond issued on or after the 1st day of June 2005 by such company or fund or public sector company.

(x) income which is paid or payable by an infrastructure capital company or infrastructure capital fund or a public sector company in relation to a zero coupon bond issued on or after the 1st day of June 2005 by such company or fund or public sector company.

(xi) to such income credited or paid by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid during the financial year does not exceed fifty thousand rupees.

The responsible person may, at the time of making any deduction increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of any previous deductions or failure to deduct during the financial year.

The responsible person shall file a quarterly return in Form No. 26Q with in 15 days from end of quarter and for the quarter ending on 31st March will be submitted by 15th May following the close of the financial year showing the names and addresses of the person and the amount paid or credited to each of such person.

With effect from 1.6.2002, individuals and HUF covered under Section 44AB(a) and (b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ₹60,00,000 (or receipts from the profession ₹15,00,000), are also required to deduct tax at source.

Cheque discounted charges are different from interest payments and provisions of Section 194A are not attracted. *ITO v. A.S. Babu Sah* (2003) 86 ITD 283 (Mad.)

(5) Winnings from Lotteries or Crossword Puzzles (Section 194B)

The person responsible for paying to any person any income by way of winnings from lotteries or crossword puzzles or card game and other game of any sort, an amount exceeding ₹10,000 shall deduct tax at the prescribed rates at the time of such payment and a statement in Form No. 26 has to be filed by the end of the month of June falling in the financial year immediately following the previous year. No such deduction shall be made from any such payment before 1.6.1972.

**Rate of Tax:**

The prescribed rate is 30%. No surcharge, education cess or SHEC shall be added from 1st October 2009. *When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.*

**Important Points**

(i) *When the prize is given partly in cash and partly in kind, income-tax will be deducted from cash prize with reference to the aggregate amount of the cash prize and the value of the prize in kind.*
(ii) No income-tax will be deducted from the prize given only in kind.

(iii) When the prize is given in instalments, the tax will be deducted only at the time of actual payment of each instalment.

(iv) Income-tax is not deductible from the income by way of bonus or commission paid to lottery agent or sellers of lottery tickets on the sales made by them.

Prizes won by lottery agent under “Lucky dip draws” are lotteries for the purposes of deduction of tax at source (Circular dated 11-2-1980).

(6) Winnings from Horse Races (Section 194BB)

Income-tax has to be deducted at source from any income by way of winnings from horse races at such rate as may be prescribed by the annual Finance Act. Deduction of tax at source will be made only in cases where the income by way of winnings from horse races to be paid to a person exceeds ₹5,000. The obligation to deduct tax at source will apply only where such winnings are paid by a book maker or a person to whom a licence has been granted by the Government under any law for the time being in force for horse racing in any race course or for arranging for wagering or betting in any race course.

Rate of Tax:

The prescribed rate is 30%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 30%.

(7) Payment to Resident Contractor or Sub-contractor (Section 194C)

Any person responsible for paying to any of the contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Rate of Tax:

(i) 1% where the payment is being made or credit is being given to an individual or a Hindu undivided family;

(ii) 2% where the payment is being made or credit is being given to a person other than an individual or a Hindu undivided family, of such sum as income-tax on income comprised therein.

* No surcharge, education cess or SHEC shall be added from 1st October, 2009.

** When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.
No individual or Hindu undivided family shall be liable to deduct income-tax on the sum credited or paid to the contractor.

No deduction shall be made from the amount of any sum credited or paid to the contractor, if such sum does not exceed ₹ 30,000.

Provided that where the aggregate of the amounts credited or paid during the financial year exceeds ₹ 75,000 the person responsible for paying shall be liable to deduct income-tax.

No deduction shall be made from any sum paid or credited during the previous year to the account of a contractor during the course of business of plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number, to the person paying or crediting such sum.

Explanation.—For the purposes of this section,—

(i) Any person, being an individual or a Hindu undivided family or an association of persons or a body of individuals, if such person,—

(A) does not covered above and

(B) is liable to audit of accounts under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor; shall be liable to deduct income tax from such sum paid or credited.

(ii) “contract” shall include sub-contract;

(iii) “work” shall include—

(a) advertising;

(b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

(c) carriage of goods or passengers by any mode of transport other than by railways;

(d) catering;

(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer, but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer.

(8) Insurance Commission (Section 194D)

Any person responsible for paying to a resident any income by way of commission or otherwise for soliciting or procuring insurance business (including continuance or renewal of policies) shall, at the time of crediting the account of the payee or at the time of payment thereof, whichever is earlier. No deduction shall be made from the amount of any sum credited or paid to, if such sum does not exceed ₹ 20,000.
(9) Payment in respect of Deposits under National Savings Scheme etc. (Section 194EE)

The person responsible for paying to any person any amount referred to in Section 80CCA(2)(a) shall, at the time of payment thereof, deduct income-tax at the rate of 20%. No deduction shall, however, be made under Section 194EE where the amount of such payment or the aggregate of such payment to the payee during the financial year is less than ₹ 2,500. Further, nothing contained in Section 194EE shall apply to the payment of the said amount to the heirs of the assessee.

(10) Commission, etc. on sale of lottery tickets (Section 194G)

Any person paying any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets on amounts exceeding ₹ 1,000 shall deduct income-tax at the rate of 10%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%. 

Provided that no deductions shall be made under this section in a case where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of, or to, the payee, does not exceed Rs, 5,000.
Individuals and HUF covered under Section 44AB(a) and (b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ₹60,00,000 (or receipts from the profession ₹15,00,000), are also required to deduct tax at source.

(13) Rent (Section 194-I)

A new Section 194-I in the Income-tax Act relating to deduction of Income-tax at source has been inserted by the Finance Act, 1994.

Any person other than an individual or a HUF who is responsible for paying to a resident any income by way of rent is required to deduct tax from rent if such rent is in excess of ₹1,80,000 per financial year. Tax is to be deducted @ 2% for use of any machinery or plant or equipment; and @ 10% for the use of any land or building (including factory building) or furniture or fittings No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

Explanation: For the purpose of this section:

(i) “rent” means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or any building (including factory building), together with furniture, fittings and the land appurtenant thereto, whether or not such building is owned by the payee.

(ii) where any income is credited to any account, whether called “suspense account” or by other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

Individuals and HUF covered under Section 44AB(a) and (b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ₹60,00,000 (or receipts from the profession ₹15,00,000), are also required to deduct tax at source.

Payment made to C&F agent are regarded as payment made for carrying out work under Section 194C instead of treating it as rent. - National Panasonic India (P) Ltd. v. CIT (TDS) (2005) 35 OT 16 Del. Payment for advertisement for boarding site is dealt under Section 194C. - ITO v. Roshan Publicity (P) Ltd. (2005) 45 OT 105 Mum. Landing and Parking Fee received by Airport Authorities is treated as rent as was decided in the case United Airlines v. CIT (2006) 152 Taxman 516 Del.

(14) Professional and technical fees (Section 194J)

Any person other than an individual or a HUF is required to deduct tax @ 10% on professional or technical fees at the time of payment or credit whichever is earlier if the aggregate of such fees given to a person is likely to be more than ₹30,000 in a previous year. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.
(15) **Payment of compensation on acquisition of capital asset (Section 194LA)**

This section has been inserted by Finance (No. 2) Act, 2004 w.e.f. 1.10.2004. It applies to any person responsible for paying to a resident any sum being in the nature of compensation or enhanced compensation or consideration or enhanced consideration on account of compulsory acquisition of any asset under any law for the time being in force. Such person, at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode whichever is earlier, shall deduct an amount equal to 10% and no surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20% of such sum as income tax on income comprised therein. However, no deduction shall be made where the amount of such payment or aggregate of such payments during the financial year does not exceed ₹ 1 lakh.

(16) **Payments of other sums to Non-residents (Section 195)**

Any person responsible for paying to a non-resident or foreign company any interest or any other sum chargeable to income-tax in India, not being salaries, shall at the time of payment, deduct tax at the rates in force.

However, no such deduction shall be made in respect of any dividends referred to in Section 115-O.

In the case of interest payable by the government or a public sector bank or a public financial institution within the meaning of Section 10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode.

Credit of any amount to ‘Suspense Account’ or any other account in the books of account of the person liable to pay such income is also deemed to be ‘credit’ of the income to the account of the payee and makes the provisions of this section applicable to such cases.

If the person responsible for such payments, feels that the whole amount would not be income chargeable in the case of recipient he may make an application to the Assessing Officer to determine the chargeable portion and he shall deduct tax on the sum so determined. Further, the assessee may apply to the Assessing Officer to grant a certificate for either no deduction of tax at source or deduction at a lower rate. If the Assessing Officer is satisfied, he can issue a certificate accordingly and the certificate shall remain in force till the expiry of the period specified therein or its cancellation by the Assessing officer whichever is earlier.

As a result of amendment made by the Finance (No. 2) Act, 1991 with effect from 1.10.1991 in Section 195, reference to the word ‘dividend’ has been omitted.

Payment made by Indian company to U.S. Company for use of its database is not subjected to TDS under Section 195 of the Income Tax Act. - WIPRO Ltd. v. I.T.O. (2005) 94 ITD 9 (Bang.).]
Test Your Knowledge

1. In which of the following cases is tax required to be deducted at source?
   (a) Interest credited or paid by a co-operative society to its members
   (b) Interest paid by a bank on the savings account balance.
   (c) Interest paid by an individual to a bank on housing loan
   (d) Interest paid by a bank on fixed deposit

   **Correct answer: (d)**

2. In case of winnings from lotteries and crossword puzzles under Section 194B
   30% income-tax will be deducted from the prize given only in kind.
   - True
   - False

   **Correct answer: False**

3. Under Payment in respect of Deposits under National Savings Scheme, Section 194EE,
   deduction shall not be made if the amount of payment or the aggregate of payment to the payee
   during the financial year is less than__________.
   (a) ₹ 1,500
   (b) ₹ 2,500
   (c) ₹ 3,500
   (d) ₹ 4,500

   **Correct answer: (b)**

4. What maximum amount of rent payment does not require deduction of tax at source per financial year?
   (a) ₹ 60,000
   (b) ₹ 90,000
   (c) ₹ 1,20,000
   (d) ₹ 1,80,000

   **Correct answer: (d)**

5. Which of the following relates to the meaning of ‘rent’?
   (a) Payment under lease
   (b) Payment under purchase
   (c) Payment under sub-lease
   (d) Payment under tenancy

   **Correct answer: (a), (c) and (d)**
(17) **Other Provisions**

Section 196 provides that no deduction of tax shall be made (notwithstanding anything contained in the foregoing provisions of Chapter XVII) by any person from any sums payable to—

(i) the Government; or  
(ii) the Reserve Bank of India; or  
(iii) a corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income-tax on its income; or  
(iv) a Mutual Fund specified under Section 10(23D);  

where such sum is payable to it by way of interest or dividend in respect of any securities or shares owned by it or in which it has full beneficial interest, or any other income accruing or arising to it.

Where in the case of any income of any person, the Assessing Officer is satisfied that the total income of the person justifies the deduction of income-tax at any lower rate or no deduction of income-tax, he shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate. Where such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in the certificate or deduct no tax, as the case may be (Section 197).

Section 196A provides that any person responsible for paying to a non-resident, except a company, or to a foreign company, any income in respect of units of a mutual fund specified u/s 10(23D) or of the Unit Trust of India shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in case, whichever is earlier, deduct income-tax thereon @ 20%. However, no such deduction shall be made under this section if such income is credited or paid on or after the 1st day of April, 2003.

However, no deduction of tax shall be made from any income payable in respect of units of the Unit Trust of India to a non-resident Indian or a non-resident Hindu undivided family, where the units have been acquired from the Unit Trust of India out of the funds in a Non-resident (External) Account maintained with any bank in India or by remittance of funds in foreign currency, in accordance, in either case, with the provisions of the Foreign Exchange Management Act, 1999 and the rules made thereunder.

(18) **Income from units**

According to Section 196B the person responsible for making the payment in respect of units referred to in Section 115AB or by way of long-term capital gains arising from the transfer of such units is payable to an offshore fund shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of ten percent.

(19) **Income from foreign currency bonds or shares of Indian Company**

With effect from June 1, 1992, Section 196C has been inserted to provide for a deduction of income-tax at the rate of ten percent from the interest income or dividend income in respect of bonds or shares referred to in Section 115AC or by way
of long-term capital gains arising from the transfer of such bond or share capital to a non-resident. However, no such deduction shall be made in respect of any dividends referred to in Section 115-O.

The person responsible for making such payment shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode whichever is earlier, deduct the income-tax thereon @ 10%.

(20) **Income of Foreign Institutional Investors from securities:**

According to Section 196D, where any income in respect of securities referred to in clause (a) of Sub-section (1) of Section 115AD is payable to a Foreign Institutional Investor, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier, deduct income-tax at the rate of twenty per cent. However, no such deduction shall be made in respect of any dividends referred to in Section 115-O.

Also no deduction of tax shall be made from any income by way of capital gains arising from the transfer of securities referred to in Section 115AD payable to a Foreign Institutional Investor.

(21) **No deduction to be made in certain cases:**

Section 197A provides that no deduction of tax at source is to be made from (i) interest on securities, (ii) dividends, and (iii) payments in respect of deposits under NSS, etc. if the following conditions are satisfied:

(i) The recipient of such income is an individual and resident in India.

(ii) Such person furnishes a declaration in writing in duplicate, in the prescribed form and verified in the prescribed manner, to the payer of such income to the effect that the tax on his estimated total income of the previous year in which such income is to be included for computing his total income will be nil.

Sub-section 197A(1A) has been inserted with effect from June 1, 1992. This sub-section provides that in case of interest other than interest on securities, a declaration referred to above can be furnished by any person (other than a company or a firm).

The payer of the aforesaid income will deliver to Chief Commissioner or Commissioner of Income-tax one copy of the declaration (received from the recipient of income) on or before the 7th day of the month next following the month in which the declaration is furnished. If he fails to do so he will be liable to a penalty of an amount which shall not be less then one hundred rupees but which may extend to two hundred rupees for every day during which the default continues.

(22) **Tax deducted is income received (Section 198)**

The tax deducted at source is deemed to be the income received, by the assessee for the purpose of computing his income.

(23) **Certificate of tax deducted (Section 203)**

The person who deducts tax has to issue a certificate in the prescribed form to the person from whose payments deduction has been made, showing therein the particulars of payment, the date of tax deducted at source and the date of its credit to the Central Government. It is on the basis of this certificate that the payee can claim
credit for tax paid on his behalf and can claim refund, if any, due to him on the basis of tax liability for the relevant year.

(24) Consequence in the event of default (Section 201)

If a person responsible for deduction of tax at source fails to deduct the appropriate tax or, after making the due deduction fails to deposit it into the Government treasury, he shall be deemed to be an assessee in default and shall be liable to:

(i) Payment of the whole or any part of the tax as due;

(ii) Interest at the rate of 1 per cent per month or part of the month on the tax from the date on which such tax was deductible to the date on which such tax is deducted; and

(iii) Interest at the rate of 1½ per cent per month or part of the month on the tax from the date on which such tax was deducted to the date on which such tax is actually paid;

(iv) Penalty which may be as high as the amount of the tax in default, however, no penalty shall be charged under Section 221 from such person unless the Assessing Officer is satisfied that such person has, without good and sufficient reasons, failed to deduct and pay the tax; and

(v) Prosecution - where the amount of tax which the responsible person has failed to deduct or pay exceeds ₹ 1,00,000 he shall be punishable with rigorous imprisonment for a term not less than 6 months but which may be extended to 7 years and with fine. In any other case, he shall be punished with a rigorous imprisonment of a term of not less than 3 months but which may be extended to 3 years and with fine.

Where the amount of tax has not been deposited after it is deducted, the amount of tax together with the interest shall be a charge upon all the assets of the person.

The following table will give the list of forms of certificates to be issued and necessary form to be filed with Assessing Officer by the persons deducting the tax at source.

<table>
<thead>
<tr>
<th>Categories of payment</th>
<th>Form No. of Certificate</th>
<th>Form No. of return to be filed with Assessing Officer</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>(a) Salaries</td>
<td>12BA, 16, 16AA</td>
<td>24Q</td>
</tr>
<tr>
<td>(b) Interest on Securities (Government)</td>
<td>16A</td>
<td>26Q</td>
</tr>
<tr>
<td>(c) Interest on Securities (others)</td>
<td>16A</td>
<td>26Q</td>
</tr>
<tr>
<td>(d) Interest other than Interest on Securities</td>
<td>16A</td>
<td>26Q</td>
</tr>
<tr>
<td>(e) Dividends</td>
<td>16A</td>
<td>26Q</td>
</tr>
<tr>
<td>(f) Winnings from Lotteries/Crossword puzzles</td>
<td>16A</td>
<td>26Q</td>
</tr>
<tr>
<td>(g) Winnings from Horse Races</td>
<td>16A</td>
<td>26Q</td>
</tr>
<tr>
<td>(h) Payments to contractors/Sub-contractors</td>
<td>16A</td>
<td>26Q</td>
</tr>
<tr>
<td></td>
<td>Description</td>
<td>Code</td>
</tr>
<tr>
<td>---</td>
<td>-----------------------------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>(i)</td>
<td>Insurance commission</td>
<td>16A, 26Q</td>
</tr>
<tr>
<td>(j)</td>
<td>Non-resident sportsmen or sports association</td>
<td>16A, 26Q</td>
</tr>
<tr>
<td>(k)</td>
<td>National Savings Scheme etc.</td>
<td>16A, 26Q</td>
</tr>
<tr>
<td>(l)</td>
<td>Income on repurchase of units by mutual funds or UTI</td>
<td>16A, 26Q</td>
</tr>
<tr>
<td>(m)</td>
<td>Commission, Remuneration or Reward on sale of lottery tickets</td>
<td>16A, 26Q</td>
</tr>
<tr>
<td>(n)</td>
<td>Payment to non-resident</td>
<td>16A, 27Q</td>
</tr>
<tr>
<td>(o)</td>
<td>Foreign company being unit holders of mutual fund</td>
<td>16A, 27Q</td>
</tr>
<tr>
<td>(p)</td>
<td>Units held by offshore fund and income from foreign currency bonds</td>
<td>16A, 27Q</td>
</tr>
<tr>
<td>(q)</td>
<td>Rent</td>
<td>16A, 26Q</td>
</tr>
<tr>
<td>(r)</td>
<td>Commission (not being insurance commission) or brokerage</td>
<td>16A, 26Q</td>
</tr>
<tr>
<td>(s)</td>
<td>Fee for professional or technical services</td>
<td>16A, 26Q</td>
</tr>
</tbody>
</table>

**E-TDS Return**

E-TDS return is prepared in the form Nos. 24Q, 26Q or 27Q in electronic media as per prescribed data structure either in a floppy or in a CD-ROM. The floppy or CD-ROM prepared should be accompanied by Form No. 27A should be signed and verified in the prescribed manner. As per Section 206 of the Income Tax Act, Corporate and Government deductors are compulsorily required to file their TDS return through electronic media. However, for other deductors filing of e-TDS return is optional and e-TDS return should be filed under Section 206 of the Income Tax Act in accordance with a scheme dated 26th August, 2003 for electronic filing of TDS return vide CBDT Circular No.8 dated 19.09.2003. The CBDT has appointed the Director General of Income Tax (Systems) as e-filing administrator for the purpose of electronic filing of returns of TDS Scheme, 2003. CBDT has also appointed National Securities Depository Limited (NSDL) as e-TDS intermediary. E-TDS return can be filed at any of the TIN-FC opened by the e-TDS intermediary for this purpose. The due date for filing quarterly TDS return both electronic and conventional form remains the same.

**Test Your Knowledge**

If a person responsible for deduction of tax at source fails to deduct the appropriate tax, or after making the due deduction fails to deposit it into the Government treasury, he is liable to prosecution.

- True
- False

Correct answer: True
(b) Advance Payment of Tax

The computation of advance tax liability, under different situations, is to be done as follows:

Section 207-219 of the Income Tax Act deals with the issues relating to advance payment of tax. In advance payment of tax, the assessee has to pay tax in a financial year under estimated income which is to be taxed in the subsequent assessment year. It follows the doctrine known as pay as you earn scheme.

Adjustment of Advance Tax

Under Section 219, the total advance tax paid by an assessee other than for interest be adjusted against the total tax liability computed under regular assessment.

Under Section 234B of the Act where an assessee, who is liable to pay advance tax, under Section 208 has failed to pay such tax or where the advance tax paid under Section 210 is less than 90% of the assessed tax, he shall be liable to pay interest @ 1% for every month or part of the month.

Assessee has to pay advance tax even in respect of book profit tax under Section 115JB otherwise it is liable for interest under Sections 234B and 234C – CIT v. Kotak Mahindra Financial Ltd. (2004) 264 ITR 119 (Bom.).

The provision of Sections 234B and 234C for interest or default in payment of advance tax and deferment of advance tax would also be applicable where facts of the tax warrant vide Circular No. 13/201, dated 9.11.2001.

It is kind of mandatory payment of tax, assessed by the assessee himself on income before completion of the Financial Year.

Liability of the Assessee

It is obligatory for an assessee to pay advance tax where the advance tax payable is ₹10,000 or more (Section 208).

Due Dates for Payment of Advance Tax

<table>
<thead>
<tr>
<th>Particulars</th>
<th>In case of corporate assessee</th>
<th>In case of non-corporate assessee</th>
</tr>
</thead>
<tbody>
<tr>
<td>On or before June 15 of the</td>
<td>Upto 15% of the Advance Tax due</td>
<td>—</td>
</tr>
<tr>
<td>Previous year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>On or before September 15 of the</td>
<td>Upto 45% of the Advance Tax due as reduced by amount paid in</td>
<td>Upto 30% of the advance tax payable.</td>
</tr>
<tr>
<td>previous year</td>
<td>earlier instalments</td>
<td></td>
</tr>
<tr>
<td>On or before December 15 of the</td>
<td>Upto 75% of the Advance Tax due as reduced by amount paid in</td>
<td>Upto 60% of the advance tax payable as reduced by</td>
</tr>
<tr>
<td>previous year</td>
<td>earlier instalments</td>
<td>amount paid in earlier instalments</td>
</tr>
</tbody>
</table>

Due Dates for Payment of Advance Tax

<table>
<thead>
<tr>
<th>Particulars</th>
<th>In case of corporate assessee</th>
<th>In case of non-corporate assessee</th>
</tr>
</thead>
<tbody>
<tr>
<td>On or before June 15 of the</td>
<td>Upto 15% of the Advance Tax due</td>
<td>—</td>
</tr>
<tr>
<td>Previous year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>On or before September 15 of the</td>
<td>Upto 45% of the Advance Tax due as reduced by amount paid in</td>
<td>Upto 30% of the advance tax payable.</td>
</tr>
<tr>
<td>previous year</td>
<td>earlier instalments</td>
<td></td>
</tr>
<tr>
<td>On or before December 15 of the</td>
<td>Upto 75% of the Advance Tax due as reduced by amount paid in</td>
<td>Upto 60% of the advance tax payable as reduced by</td>
</tr>
<tr>
<td>previous year</td>
<td>earlier instalments</td>
<td>amount paid in earlier instalments</td>
</tr>
</tbody>
</table>
On or before March 15 of the previous year  Upto 100% of the Advance Tax due as reduced by amount paid in earlier instalments  Upto 100% of the advance tax payable as reduced by amount paid in earlier instalments

Any payment of advance tax payable made before March 31 shall be treated as advance tax paid during the financial year.

In case of public holiday or bank holiday, date of payment automatically falls in the next working day and for that delay, interest is not charged under Sections 234B and 234C vide Circular No. 676 dated 14.01.1994.

**Computation of Tax**

Tax to be computed at the prevailing rate on the current income of the assessee, in a financial year.

**Role of Assessing Officer in relation to Advance Payment of Tax**

An Assessing Officer (AO) can order payment of advance tax if following conditions are satisfied:

(i) The assessee has already been assessed by way of regular assessment in respect of total income of any previous year.;

(ii) Failure to pay tax by such assessee.

(iii) The AO is of the opinion that such person is liable to pay advance tax on current year's income.

(iv) The order must specify the amount of advance tax and instalments in which advance tax has to be paid.

(v) Such order may be passed during the previous year but not later than last day of February.

(vi) The order must be made in writing.

The assessee can pay advance tax at a rate lower than assessment made by the AO and the department cannot object to such assessment, but he has to furnish his own estimate of income in Form No. 28A – *Punjab Tractors Ltd. v. CIT* (2004) 137 Taxman 211 (Punjab & Haryana).

For higher estimate made by the assessee, Form 28A is not required to be furnished.

The AO will find out the current income on the following basis:

(i) Total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment;

(ii) The total income returned by the assessee for any previous year subsequent to the previous year for which regular assessment is made. whichever is higher;

AO can revise his order passed under Section 210(3) [Section 210(4)]
If after making the order under section 210(3), but before 1\textsuperscript{st} March (a) a return has been furnished by the assessee, (b) a regular assessment of the assessee is made, in respect of a later previous year, for a higher figure, then the Assessing officer may revise or amend his order.

On receipt of the order the assessee have to pay the advance tax accordingly.

9.3 **REFUNDS (Sections 237 to 245)**

Refund means “to repay” or restore what was taken under the income-tax law. Refunds arise in those cases where the amount of tax paid by a person or on his behalf is greater than the amount with which he is properly chargeable for that year. Under the following circumstances the refunds may become due:

(i) The tax deducted at source is higher than the amount of tax payable, as determined on regular assessment;

(ii) The amount of advance tax paid or tax paid on the basis of self-assessment exceeds the tax payable as determined on regular assessment;

(iii) The tax determined and paid on the basis of regular assessment gets reduced as a result of rectification of mistake which had crept in the assessment or is reduced in appeal or revision;

(iv) The same income is taxed in India and in a foreign country and the assessee is entitled to double taxation relief.

For claiming refund it is necessary that the income in respect of which refund of tax is being claimed must have been included in his total income as per the return of Income.

Every claim for refund under this chapter shall be made in the prescribed Form (No. 30) within one year from the last day of the assessment year to which the claim is related. If the assessee has not filed the return of income he must file the return along with the certificate/s of tax deducted at source, challans for payment of tax, salary certificate and/or tax paid in a foreign country. The dividend warrants and other certificates should be filed in original, duly signed by the assessee, to evidence the ownership of shares etc., from which the income is derived. If, for some reason, the original certificates are not traceable, duplicates issued by the concerned companies may be furnished. However, in such cases an indemnity bond stating that the original certificates are not traceable and no refund in respect of such warrants had already been claimed, should also accompany the claim. Indemnity bond should be on a stamp paper of the prescribed value depending upon the amount of tax deduction.

Where refund arises on completion of assessment on account of excess payments of advance tax or on self-assessment or it results on account of reduction in appeal, revision or rectification of mistakes, no formal application for refund is required. The Assessing Officer shall grant such refund on his own. However, where an assessment is set aside or cancelled by virtue of such an order and an order of fresh assessment is directed to be made, the refund if any, shall become due only on the making of fresh assessment. In cases where the assessment is annulled, the refund shall become due only of the amount of tax paid in excess of the tax chargeable on the total income returned by the assessee (Section 240).
However, the assessing officer is authorised to admit a belated refund claim subject to satisfying the following conditions:

(a) the refund arising as a tax deducted at source under Section 192, 193, 194, 194A, 194B, 194C, 194D and 195 or as a result of excess advance tax payments under Section 208, does not exceed ₹10,000;

(b) the returned income is not a loss, where the assessee claims the benefit of carry forward of the loss;

(c) the refund claimed is not supplementary in nature i.e. a claim for additional amount of refund after the completion of the original assessment for the same year; and

(d) the income of the assessee is not assessable in the hands of any other person under any provisions of the Act.

**Whom to apply for refund?**

Claim for refund should be preferred to the Assessing Officer having jurisdiction to assess the assessee.

In bigger towns like Delhi, Bombay, Calcutta, Madras, separate Refund Circles have been opened to settle refund cases. However, these circles settle refund cases where income is restricted to ‘Other Sources’.

**Who is entitled to refund:** Any one of the following persons can apply for the refund:

(i) Owner of the income who has made excess payment;

(ii) Where the income of a person is included in the hands of another, only the latter is entitled to refund;

(iii) In case of death of the assessee, his legal representative;

(iv) In case of insolvency of the assessee - the receiver;

(v) In case of liquidation of a company - the liquidator of the company;

(vi) In case of minor or incapable assessee - the guardian of the minor or incapable;

(vii) In case of non-resident assessee - his agent provided he has been duly authorised by the principal; and

(viii) In case of dissolved partnership firm - any partner provided he has been duly authorised by all other ex-partners of the firm.

**Issue of Refund:** If the Assessing Officer is satisfied that the refund claim is complete and in order, he shall complete the assessment and issue a refund voucher payable at the Reserve Bank or the State Bank or any treasury. The refund voucher is encashable like any other cheque, within three months from the date of issue. If the assessee fails to encash it within the prescribed time (3 months from the date of issue), he should send it to the Assessing Officer who will cancel it and issue a fresh one. If the applicant is a resident and the amount of refund is small, the amount may be sent by money order at Government cost. Where the assessee is a non-resident, generally a Bank Draft is sent at his cost.

**Adjustment of Refund:** All refunds may not be settled by actual payments. Wherever it is found that tax for some other years (either earlier or subsequent to the
year to which the refund relates) are outstanding against the assessee, the refund due may be adjusted against the outstanding demand and the balance, if any, refunded to him. However, the amount can be adjusted only after giving an intimation in writing to the assessee of the action proposed to be taken for the purpose.

**Interest on Refunds:** Section 244A, provides that where, in pursuance of any order passed under the Income-tax Act, refund of any amount becomes due to the assessee, he shall be entitled to receive, in addition to the said amount, simple interest thereon calculated in the following manner:

(a) Where the refund is out of any tax collected at source under Section 206C or paid by way of advance tax or treated as paid under Section 199, during the financial year immediately preceding the assessment year, interest calculated at the rate of one half per cent for every month or part of a month comprised in the period from 1st day of April of the assessment year to the date on which the refund is granted. But, if the amount of refunds is less than ten per cent of the tax as determined on regular assessment, no interest shall be payable. However, no interest shall be payable if the amount of refund is less than ten percent of the tax as determined under Sub-section (1) of Section 143 or regular assessment.

(b) In any other case, such interest has to be calculated at the rate of one half per cent for every month or part of a month comprised in the period or periods from the date or dates of payment of the tax or penalty to the date on which the refund is granted (The “date of payment of tax or penalty” means the date on and from which the amount of tax or penalty; specified in the demand notice under Section 156 is paid in excess of such demand).

(c) The assessee is not entitled to any interest on refund where a delay in payment thereof takes place for reasons attributable to the assessee. Any question as to the period to be excluded has to be decided by the Chief Commissioner or Commissioner whose decision thereon shall be final.

(d) In the event of increase or reduction of the amount on which the interest is payable (as a consequence of an order 143(3); 144; 147; 154; 155; 250; 254; 260; 262; 263; 264; or 245D(4), interest payable is to be increased or reduced accordingly. In the case of subsequent reduction of the interest, the Assessing Officer has to serve a demand notice on the assessee requiring him to pay back such amount as has been paid in excess.

The provisions of this section shall apply in respect of assessments for the assessment year commencing on the 1st day of April, 1989 and subsequent years. However, in respect of assessment of fringe benefits, the provisions of this Sub-section shall have effect as if for the figures “1989”, the figures “2006” had been substituted.

**9.4 FOR FAILURE TO DEDUCT AND PAY TAX AT SOURCE (SECTION 201)**

Where any person, including the principal officer of a company

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) being an employer,
does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, then, such person, shall be deemed to be an assessee in default in respect of such tax:

Provided that no penalty shall be charged under section 221 from such person, unless the Assessing Officer is satisfied that such person, without good and sufficient reasons, has failed to deduct and pay such tax.

Without prejudice to the above provisions, if any such person, principal officer or company as is referred to in that sub-section does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required by or under this Act, he or it shall be liable to pay simple interest at one per cent for every month or part of a month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid.

9.5 FOR BELATED PAYMENT OF INCOME-TAX [Section 220(2)]

An assessee is liable to pay interest @ 1% for every month or part thereof comprised in the period intervening between the expiry of 30 days w.e.f. serving of the notice of demand and actual payment of tax for the delay in making the payment of tax demanded beyond 30 days from the date of receipt of the demand notice.

Sub-section (2A) of Section 220, empowers the Board to reduce or waive the amount of interest payable by an assessee under the above section on the recommendation made by the Chief Commissioner or Commissioner in this behalf. The Board’s order will be passed only upon satisfaction that:

(a) the payment of such interest has caused or would cause genuine hardship to the assessee;

(b) the default in the payment of the amount on which interest has been paid or was payable was due to circumstances beyond the control of the assessee; and

(c) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for recovery of any amount due from him.

9.6 INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME (Section 234A)

In cases where a return on income is furnished after the due date or is not furnished at all, the assessee has to pay simple interest at the rate of 1% per cent for every month or part of the month of default on the amount of tax on the total income as determined under sub-section (1) of Section 143, and where a regular assessment is made, on the amount of the tax or the total income determined under regular assessment or reduced by an amount of (1) advance tax if paid; (2) any TDS/TCS; (3) any relief under Sections 90, 90A; (4) any deduction under Sections 91; (5) any tax credit under the provisions of Section 115JAA.

The period for which the interest is payable commences from the date immediately following the due date for filing the return and ending on the date of furnishing of the return. Where the return is not furnished, the interest will be payable from the due date for filing the return till the date of completion of assessment.
9.7 INTEREST FOR DEFAULT IN PAYMENT OF ADVANCE TAX (Section 234B)

Where the assessee, liable to pay advance tax, has not remitted the same or
Where the advance tax paid is less than 90 per cent of assessed tax

He has to pay simple interest on assessed tax means the tax on the total income
determined under subsection(1) of section 143 and where a regular assessment is
made, the tax on the total income determined under such regular assessment as
reduced by the amount of (1) advance tax, if any paid; (2) any TDS/TCS; (3) any
relief under Sections 90, 90A; (4) any deduction under Section 91; (5) any tax credit
under provision of Section 115JAA @1% percent for every month or part of month
from 1st day April next following such financial year to the date of determination of
total income under section 143(1) and where a regular assessment is made, to the
date of such regular assessment.

In cases where the assessee has paid tax on the basis of self assessment under
Section 140A, before the date of completion of a regular assessment, the interest is
calculated on above basis up to the date of payment of tax under Section 140A and,
the thereafter, on the amount by which the advance tax and tax paid under Section
140A fall short of advance tax.

In the cases of enhancement or reduction of the amount on which interest was
payable under Section 147 (income escaping assessment) or Section 153A;
Section 154 (rectification of mistake); Section 155 (other amendments on completed
assessment of a partner in a firm; member of an AOP or body of individuals etc.);
Section 250 (appeal); Section 254 (orders of the Appellate Tribunal); Section 260
(Decision of High Court or Supreme Court on the case stated; Section 262 (hearing
before Supreme Court); Section 263 (revision of orders prejudicial to revenue);
Section 264 (Revision of orders); or 245D(4) [order of the Settlement Commission,
the interest shall be increased or reduced correspondingly. Where the interest has
already been paid to the assessee, a notice of demand, calling for payment of such
amount, has to be served on the assessee by the Assessing Officer. Such notice of
demand shall be deemed to be an order under Section 156 of the Act.

9.8 INTEREST FOR DEFERMENT OF ADVANCE TAX (Section 234C)

If the assessee (non-corporate assessee) who is liable to pay advance tax
under Section 208 has failed to pay such tax or has underestimated the instalments
of advance tax, he has to pay interest as follows:

(i) If advance tax paid on or before 15 September is less than 30% of tax due on
total income declared in the return filed by the assessee, the assessee shall
pay simple interest @ 1% per month for a period of three months on the
amount of the shortfall from thirty per cent of the tax due on the returned
income.

(ii) If advance tax paid on or before 15 December is less than 60% of tax on total
income declared in the return, the assessee shall pay simple interest @ 1%
per month for a period of three months on the amount of the shortfall from
sixty per cent of the tax due on the returned income.
(iii) If advance tax paid on or before March 15 is less than 100% of tax due on total income declared in the return, as reduced by tax deducted at source, simple interest is payable @ 1% per month on the amount of shortfall from the tax due on the returned income declared.

If the assessee (corporate assessee) who is liable to pay advance tax under Section 208 has failed to pay such tax or has underestimated the instalments of advance tax, he has to pay interest as follows:

(i) If advance tax paid on or before 15 June is less than 15% of tax due on total income declared in the return or If advance tax paid on or before 15 September is less than 45% of tax due on total income declared in the return filed by the assessee or If advance tax paid on or before 15 December is less than 75% of tax due on total income declared in the return the assessee shall pay simple interest @ 1% per month for a period of three months on the amount of the shortfall from 15%, 45%, and 75% of the tax due on the returned income.

(ii) If advance tax paid on or before March 15 is less than 100% of tax due on total income declared in the return, as reduced by tax deducted at source, simple interest is payable @ 1% per month on the amount of shortfall from the tax due on the returned income declared.

The following explanation shall be substituted w.e.f. 1.4.2007, namely:

"Explanation: in this section "tax due on the returned income" means the tax chargeable on the total income declared in the return of income furnished by the assessee for the assessment year commencing on the 1st day of April immediately following the financial year in which the advance tax is paid or payable, as reduced by the amount of:- (1) any TDS/TCS (2) any relief of tax under Section 90 or 90A (3) any deduction under Section 91 (4) any tax credit u/s 115JAA."

9.9 INTEREST RECEIVABLE BY THE ASSESSEE

SECTION 244A (INTEREST ON REFUNDS)

(a) If the amount of refund is not less than ten per cent of the tax as determined on regular assessment, and the refund is out of any tax collected at source under Section 206C or treated as paid under Section 199, during the financial year immediately preceding the assessment year, interest shall be payable at the rate of ½ per cent for every month or part of a month comprised in the period from 1st day of April of the assessment year to the date on which the refund is granted;

No interest shall be payable if the amount of refund is less than ten percent of the tax as determined under 143(1) on regular assessment.

(b) in any other case, at the rate of one half per cent for every month or part of the month comprised in the period or periods from the date or, dates of payment of the tax or penalty to the date of grant of refund.

The "date of payment of tax or penalty" means the date on and from which the amount of tax or penalty specified in the notice of demand issued under Section 156 is paid in excess of such demand.

However, where the proceedings resulting in the refund are delayed for reasons attributable to the assessee, whether wholly or partly, the period of delay so
attributable to him shall be excluded as per the decision taken by the Chief Commissioner or Commissioner (his decision thereon shall be final).

In the cases of enhancement or reduction of the amount on which interest was payable under Section 143 (Assessment); Section 144 (Best Judgement Assessment); Section 147 (income escaping assessment); Section 154 (rectification of mistake); Section 155 (other amendments on completed assessment of a partner in a firm; member of an AOP or body of individuals etc.); Section 250 (appeal); Section 254 (orders of the Appellate Tribunal); Section 260 (decision of High Court or Supreme Court on the case stated); Section 262 (hearing before Supreme Court); Section 263 (revision of orders prejudicial to revenue); Section 264 (revision of other orders); or 245D(4) (order of the Settlement Commission), the interest shall be increased or reduced correspondingly. Where the interest has already been paid to the assessee, a notice of demand, calling for payment of such amount, has to be served on the assessee by the Assessing Officer. Such notice of demand shall be deemed to be an order under Section 156 of the Act.

**LESSON ROUND UP**

- This chapter gives detailed picture of procedural aspects regarding TDS matters and advance tax matters.
- The provisions of advance tax, refund of tax, interest on delay payment discussed.

**SELF TEST QUESTIONS**

1. Describe briefly the procedures regarding collection and recovery of Tax by the authorities.

2. What is Tax deducted at Source?

3. Explain the procedures regarding refund of excess tax paid by the assessee to the Department.
The Wealth Tax Act 1957 is basically tax on tangible property like real estate, jewellery and other personal effects. This chapter covers entire aspects of wealth tax starting from valuation of assets, rates, net wealth, return assessment, payment mode, settlements, and penalties to offences and prosecutions.

LEARNING OBJECTIVES

This chapter covers the following topics/concepts:

- Charge of Tax
- Incidence of Wealth-tax
  1. In the case of an Individual
     a. Who is not a citizen of India (whether non-resident or not ordinarily resident in India?)
     b. Who is citizen of India and resident in India?
     c. Who is a citizen of India but non-resident or not ordinarily resident in India
  2. Hindu Undivided Family
     a. Resident in India
     b. Non-resident or not ordinarily resident in India
- Valuation Date [Section 2(q)]
- Tax Rate
- Net Wealth
  1. Computation of Net-wealth
  2. Assets
  3. Assets belonging to others but includible in the net-wealth of an individual
  4. Assets exempt from wealth-tax
  5. Debts and Liabilities
  6. Location of Assets and Debts
  7. Valuation of Assets
     a. Valuation of Immovable property
(B) Valuation of assets of business
(C) Valuation of interest in firm or association of persons
(D) Valuation of Life Interest
(E) Valuation of Jewellery
(F) Valuation of other assets
(8) Rounding off of net wealth

Illustrations
- Return of Wealth
  (1) Voluntary Return
  (2) Return after Due Date and Amendment of Return (Section 15)
- Assessment
  (1) Self Assessment [Section 15B]
  (2) Assessment
  (3) Wealth Escaping Assessment (Section 17)
  (4) Time limit for completion of Assessment and Re-assessment
- Liability to Assessment in Special Cases
  (1) Tax of Deceased Person Payable by Legal Representative (Section 19)
  (2) Assessment in the case of Executors (Section 19A)
  (3) Assessment after Partition of a Hindu Undivided Family (Section 20)
  (4) Assessment after Partial Partition of a Hindu Undivided Family (Section 20A)
  (5) Assessment of Charitable Trusts (Section 21A)
  (6) Assessment of an Association of Persons (Section 21AA)
  (7) Assessment of Persons Residing outside India (Section 22)
- Payment and Recovery of Wealth-Tax
  (1) Notice of Demand (Section 30)
  (2) Liability of Transferees of Properties (Section 33)
- Refunds (Section 34A)
- Rectification of Mistakes (Section 35)
- Settlement of Cases
- Appeals, Revisions and References
  (1) Appeal to the Commissioner (Appeals) [Section 23(1)]
  (2) Appeal to Commissioner (Appeals) [Section 23(1A) & (B)]
  (3) Appeal to the Appellate Tribunal (Section 24)
  (4) Revisions of Orders by Commissioner (Section 25)
  (5) Reference to the High Court (Sections 27)
  (6) Appeal to High Court (Section 27A)
  (7) Appeal to Supreme Court (Section 29)
Penalties under the Wealth-Tax Act

(1) Penalties Imposable under Wealth-tax Act
(2) Failure to Pay Tax (Section 31)

Power to Reduce or Waive Penalty (Section 18B)

Offences and Prosecutions (Sections 35A to 35N)

(1) Willful Attempt to Evade Tax etc. (Section 35A)
(2) Failure to Furnish Returns of Net Wealth (Section 35B)
(3) Failure to Produce Accounts and Documents (Section 35C)
(4) False Statement in Verification (Section 35D)
(5) False Statement in Verification by Registered Valuers (Section 35E)
(6) Failure to furnish particulars under Section 34ACC (Section 35EE)
(7) Contravention of order made under Section 37A (Section 35EEE)
(8) Abetment of False Return, etc. (Section 35F)
(9) Punishment for Second and Subsequent Offences (Section 35G)
(10) Offences by H.U.F. (Section 35H)
(11) Offences by companies (Section 35HA)
(12) Prosecutions to be at the instance of Chief Commissioner or Commissioner and power of Chief Commissioner to compound offences (Section 35-I)
(13) Certain offences to be non-cognizable (Section 35J)
(14) Bar on Prosecution (Section 35K)
(15) Jurisdiction of Courts (Section 35L)
(16) Section 360 of the code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958 not to apply (Section 35M)
(17) Immunity from Prosecution (Section 36A)

10.1 CHARGE OF TAX

As per section 3 of the Wealth Tax Act,

- The wealth-tax is charged for every assessment year commencing on or after 1.4.1957.
- Wealth-tax is charged in respect of the net wealth of an assessee on the corresponding valuation date.
- Wealth tax is levied on every individual, Hindu undivided family and company.
- Before the 1st day of April, 1993, Wealth tax was charged at the rate or rates specified in Schedule I.
- From the 1st day of April, 1993, Wealth tax is charged at the rate of one per cent (1%) of the amount by which the net wealth exceeds fifteen lakh (15,00,000) rupees. From the AY 2010-11, this limit has been increased to thirty lakh (30,00,000) rupees.
- The wealth tax is charged on the net wealth of an assessee. The rate, to a particular assessee; can be applied only when the following four ingredients
are determined:

(a) The quantum of net wealth chargeable to tax under the Act;
(b) Time aspect, i.e., net wealth on the valuation date;
(c) Location of assets or place aspect; and
(d) Ownership aspect, i.e., who is the owner of the wealth on the relevant valuation date.

(i) Individual

1. The charge of tax in the status of “individual” can be levied on:
   (a) a natural person or human being;
   (b) Hindu Deity or mutawalli of a wakf as a juristic individual;
   (c) group of individuals, being trustees of a trust [Trustees of Gordhandas Govind Ram Family Charity Trust v. C.I.T. (1973) 88 ITR 47 (S.C.)];
   (d) holder of an impartible estate;

The Supreme Court’s decision in the case of Trustees of Gordhandas Govind Ram Family Charity Trust (supra) was followed by the Rajasthan High Court in the case of Commissioner of Wealth-tax v. Bhangur Charitable Trust (1987, 164 ITR 249) holding that the word ‘individual’ occurring in Section 5(1)(xxiii) of the Wealth-tax Act, 1957 includes the trustees of a trust. Therefore, a trust was entitled to exemption in respect of shares held in Indian companies under the said section.


Distinguishing the case of C.K. Mammed Kayi (supra), the Bombay High Court held in the case of Orient Club v. Commissioner of Wealth-tax (1982, 136 ITR 697) that a members’ club being an association of persons is not an individual and hence not an assessable entity for the purposes of wealth-tax. This case was followed by the Kerala High Court recently in the case of Commissioner of Wealth-tax v. Mulam Club (1991, 1991 ITR 370) holding that club is not an individual and hence not liable to wealth-tax.

(f) a Commission under Portuguese Civil Code is not an association of persons, hence, husband and wife both are assessable as individuals [CWT v. Vasudeva V. Dempo (1981, 131 ITR 291 (Bom.))].

(g) AOP, where the shares of the members are indeterminate or unknown.
The following do not come in the meaning of individual:

(i) A company even though it is apparently what may be described as legal individual because in reality it constitutes an “association of persons” to which the character of juristic personality has been given by the Companies Act. It shareholders are however, taxable individually vis-a-vis shares held by each.

(ii) A corporation established by State or Central Acts, if its property does not enure for the benefit of an individual.

(iii) A Co-operative Society, even though it has been defined by Section 2(h)(a) and at the same time, exempted from tax liability by Section 45(g) with retrospective effect from 1.4.1957, the very commencement of the Act.

(ii) Hindu Undivided Family

The expression “Hindu Undivided Family” is limited to Mitakshara families or persons or families professing Hindu religion governed by Mitakshara Law and no other family. The essence of a taxable Hindu undivided family is the unity of whole body of the family members. The individual members do not have definite and ascertained shares. Each of them has a fluctuating interest, which is capable of being enlarged or diminished by deaths or births. In view of this, a H.U.F. Governed by Dayabhaga School of Hindu Law is not a H.U.F. for wealth-tax purposes because the members of the family have definite and ascertained shares in the property of the family.

If a Hindu converts to Christianity though he follows Hindu Law of Succession, he cannot be granted the status of a H.U.F. and will be assessable as an individual only. [P.F. Pinto v. C.W.T. (1967) 65 ITR 123 (Mys.)]. However, a Jain undivided family is treated a H.U.F. [CWT v. Smt. Champa Kumari Singhi (1972) 83 ITR 720].

Where assessee an individual received 3,000 shares from his father-in-law who gave them for benefit of assessee’s HUF, consisting of assessee and his wife, and Tribunal held that as there was no HUF in existence said gift would fail but that fact would not make assessee sole owner of these shares. Tribunal was justified - CIT v. Prokash Kumar Mohte [(1989) 45 Taxman 163 (Cal.)].

Where assessee received certain amount as gift from his father on specific terms that benefit of these sums should go to his wife and children also as and when he got married and that he should enjoy it as a HUF under Hindu law income from gifted properties should be taken as HUFs Income - CWT v. M. Balasubramanian [(1989) 44 Taxman 460 (Mad.) (FB)].

Where gift was allegedly made to karta’s mother and she made gifts to her grandchildren, while gift to karta’s mother was includible in assessee - HUF’s wealth, gifts to grand-children having not been found to be non-genuine, were not includible in assessee’s - S.R. Kalani (HUF) v. CWT [(1989) 47 Taxman 72 (MP)].

After 1.12.1976, there can be no assessment in the status of a HUF in Kerala in view of the Kerala Joint Hindu Family System (Abolition) Act, 1975, with effect from 1.12.1976 - CWT v. T. Lakshmikutty Amma [(1989) 180 ITR 603 (Ker.)].
(iii) Company

The term ‘company’ is defined in Section 2(h) of the Wealth-tax Act, 1957. According to this section the term ‘company’ means the same as is defined in Section 2(17) of the Income-tax Act, 1961 which is given hereunder:

Company means:
(i) any Indian company, or
(ii) any body corporate incorporated by or under the laws of a country outside India, or
(iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922, or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970, or
(iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a Company:

Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years whether commencing before the 1st day of April, 1971 or on or after that date as may be specified in the declaration.

Persons not liable to Wealth Tax (Section 45)

Wealth-tax shall not levied in respect of the net wealth of the following:
1. any company registered under Section 25 of the Companies Act, 1956;
2. any cooperative society;
3. any social club;
4. any political party within the meaning of explanation to Section 13A of the Income-tax Act; and
5. any mutual fund within the meaning of Section 10(23D) of the Income-tax Act.

Test Your Knowledge

Which of the following person is not liable for wealth tax?
(a) Cooperative society
(b) Social club
(c) Political party
(d) Indian company
(e) Institution or association

Correct answer: (a), (b), (c)
10.2 INCIDENCE OF WEALTH-TAX

The liability to wealth-tax depends upon the citizenship and residential status of an individual and in case of a Hindu undivided family upon its residential status alone. An individual or Hindu undivided family may be resident, not ordinarily resident or non-resident in India during the previous year ending on the valuation date. The residential status of an assessee is determined in the same manner as for income-tax purposes under the Income-tax Act.

According to Section 6 of the Wealth-tax Act, 1957, the incidence to wealth-tax is as follows:

- **In the case of an Individual**

  - **Who is citizen of India and Resident**
    - All assets and debts located in and out of India are to be taken in computation of net wealth of the assessee except exempted assets and including deemed assets are chargeable.
  
  - **Who is citizen of India and NR or NOR in India and who is not a citizen of India**
    - All assets in India except the assets represented by any loans and debts-owing to the assessee interest whereon is exempt from income-tax under Section 10 of the Income-tax Act.
    - All debts in India except, the debts secured on any property or incurred in relation to any property or which wealth-tax is not payable and tax liability under any Direct Taxes, if outstanding on the valuation date and disputed by the assessee or outstanding for more than twelve months, although not disputed, are taken into account in computing the net wealth.
    - All assets (including deemed assets but excluding exempted assets) and debts located outside India are not chargeable to wealth-tax.

By virtue of explanation 1A to Section 6 of the Wealth-tax Act the credit balance in a Non-resident (External) Account (interest thereon being exempt under Section 10 of the Income-tax Act), is not taxable in the case of “a person resident outside India” within the meaning of the Foreign Exchange Management Act, 1999.
10.3 VALUATION DATE [SECTION 2(q)]

Wealth-tax is levied on the net-wealth of a person as on a particular date, this date is known as the valuation date.

The valuation date for wealth-tax purposes is the last day of the previous year as defined in section 3 of Income Tax Act, 1961.

Moreover, valuation date is a continuous period starting at the first moment and ending at the last moment of a certain day (i.e. March 31 of the relevant previous year). Hence the net wealth tax shall be taken at the last moment of the valuation date [Banarasi Dass v. CWT (1970) 76 ITR (All)].
10.4 TAX RATE

With effect from the assessment year 2010-11 onwards, as per the amended Section 3, wealth-tax shall be charged in respect of the net wealth on the corresponding valuation date of every individual, Hindu Undivided Family and company at the rate of one per cent of the amount by which the net wealth exceeds thirty lakh rupees.

10.5 NET WEALTH: [section 2(m)]

The concept of ‘net-wealth’ is very important for wealth-tax purposes because net wealth is the tax base. According to Section 2(m) “net-wealth” means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets.

Computation of Net-Wealth

<table>
<thead>
<tr>
<th>Net wealth shall be computed in the following manner:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of Assets u/s 2(ea) belong to the assessee as on valuation date</td>
</tr>
<tr>
<td>Add: Deemed assets under section 4</td>
</tr>
<tr>
<td>Less: Assets exempt u/s 5</td>
</tr>
<tr>
<td>Gross wealth</td>
</tr>
<tr>
<td>Less: Debts incurred in relation to the assets included in the net wealth</td>
</tr>
<tr>
<td>Net Wealth</td>
</tr>
</tbody>
</table>

While computing “net-wealth”, the following assets are not includible in the net-wealth of an assessee:

(i) Assets exempt under Section 5(1).

(ii) Under Section 6, in case of an individual who is not a citizen of India or who is citizen of India but a non-resident or not ordinarily resident in India during the previous year and Hindu undivided family not resident or not ordinarily resident in India or a company not resident in India, the assets and debts situated outside India and loans and investments in India from foreign sources, interest on which is exempt from income-tax under Section 10 of the Income-tax Act.

(iii) Assets lost, destroyed or stolen on or before the valuation date.

According to Section 2(ea) read with Section 2(m) of the Wealth-tax Act, the asset, to be chargeable to wealth-tax, must “belong” to the assessee on the relevant valuation date as the liability to wealth-tax arises out of ownership of the asset and not otherwise. In this connection, ownership includes deemed ownership.

The following persons having beneficial enjoyment of property are deemed as owner of immovable properties for the purpose of Section 2(m) of the Wealth-tax Act:

— a member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building
scheme of the society, company or association, as the case may be.

— A person who has taken possession of any building under an agreement to sell (which is not registered) with the vendor and paid consideration or is willing to perform his part of contract [Section 53A of the Transfer of Property Act].

— A person who acquires any right (excluding any rights by way of a lease from month to month or for a period not exceeding one year) with respect to any building by virtue of any transaction as is referred in Section 269UA(f) of the Income-tax Act.

According to Section 2(m), all the assets owned by the assessee have to be taken into consideration, irrespective of the source from which he has acquired them. For instance, property received by him as a donee (from the donor) or as a devisee (according to the Will of a deceased testator), or as intestate heir of the deceased is to be reckoned. Likewise, property acquired with the help of borrowed money or with the assistance of some other person(s) has to be taken into account. It was on this principle that the Supreme Court rejected the contention of the Calcutta Electric Supply Corporation, that the service lines constructed at the cost of consumers, and not from its own funds, were not owned by it. It was held in this case that the only relevant thing for the purposes of the Wealth-tax Act was that the assessee should be the owner of the assets in question on the relevant valuation date. Since the balance sheet showed the service connections in question as ‘assets’, value thereof was not deductible in determining the net value of ‘assets’. Mere possibility of confiscation does not impair ownership of the assessee in the articles seized. Hence, the value of the assets seized on the valuation date shall be included in the net-wealth. [Jayantilal Amritlal v. CWT (1982) 135 ITR 742 (Guj.)].

This is subject of course to the condition that the asset in question is one of the six specific assets mentioned in the exhaustive definition of ‘assets’ given in Section 2(ea).

10.5.1 Assets [Section 2(ea)]

The Finance Act, 1992 has amended the term assets with effect from the assessment year 1993-94 onwards. Accordingly, as per Section 2(ea) “assets” in relation to the assessment year commencing on the 1st day of April, 1993, or any subsequent assessment year, means:

(i) House

(ii) Motor Cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade);

(iii) Jewellery

(iv) Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);

(v) Urban land;

(vi) Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.
(i) **House**: 
1. The house means any building or land appurtenant thereto used for—
   - residential or commercial purposes
   - maintaining a guest house or
   - a farm house.
2. The house must be situated within twenty-five kilometers from local limits of any municipality/ Municipality Corporation or by any other name or a Cantonment Board.
3. The house will not include—
   - a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than five lakh rupees;
   - any house for residential or commercial purposes which forms part of stock-in-trade;
   - any house which the assessee may occupy for the purposes of any business or profession carried on by him;
   - any residential property that has been let-out for a minimum period of three hundred (300) days in the previous year;
   - any property in the nature of commercial establishments or complexes;

(ii) **Motor Car**
All motor cars whether Indian or Foreign (other than those used by the assessee in the business of running them on hire or as stock-in-trade);

(iii) **Jewellery**:
(1) Jewellery includes any jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals (other than those held by the assessee as stock-in-trade);
(2) It also includes - (i) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones, and whether or not worked or sewn into any wearing apparel; (ii) precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel;
(3) And does not include: The Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

(iv) **Yachts, boats and aircrafts** (other than those used by the assessee for commercial purposes);

(v) **Urban land**:
1. The urban land means land situated in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee,
or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the valuation date.

2. The urban land means any area located within eight kilometers from the local limits of any municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board but does not include:
   - land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or
   - the land occupied by any building which has been constructed with the approval of the appropriate authority or
   - any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him or
   - any land held by the assessee as stock-in-trade for a period of five years from the date of its acquisition by him.

(vi) Cash in hand: Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu Undivided families and in the case of other persons any amount not recorded in the books of account.

10.5.2 ASSETS BELONGING TO OTHERS BUT INCLUDIBLE IN THE NET-WORTH OF AN INDIVIDUAL (DEEMED ASSETS) SECTION 4

Ordinarily, in computing the net wealth of an assessee, only the assets which belong to him on valuation date are taken into account. However, to reduce the liability to wealth-tax, an individual may transfer his assets without adequate consideration to his spouse, son’s wife, AOP etc.

Clauses (i) to (vi) of Section 4(1)(a); Section 4(1)(b) and Sub-sections (1A), (5A) and (7) foil an attempt on the part of propertied persons to evade or to lessen their due burden of wealth-tax by the device of transferring their property in whole or in part to their spouse or son’s wife or, after December 31, 1969, converting it into the property of family, or after 1.6.1973 to their daughter-in-law. Further, w.e.f. 1.4.1980 the gift of property made by the individual to his H.U.F. is also counteracted by amending Section 4(1A). Gifts made by book entries are also includible in the donor’s taxable wealth unless he proves to the satisfaction of the Wealth-tax Officer that the money was actually delivered. Thus, the Section extends the gamut of net wealth in respect of an individual regarding certain assets transferred to the spouse or to association of persons for the benefit of individual, his or her spouse or converted into the property belonging to the Hindu undivided family of which he is a member and such assets shall be deemed as belonging to the individual for being assessable in his hands, subject to satisfaction of the following conditions:

(a) The individual must be the owner of these assets.
(b) These assets must be transferred without adequate consideration.
(c) These assets must be held by the transferee on the valuation date. If the asset has been spent, lost or destroyed before the valuation date, the value of such asset shall not be included in the net-wealth of the individual. If the
form of assets transferred is changed before the valuation date, the substituted assets shall be included in the net-wealth of the individual. If the substituted asset is one which is exempt from wealth-tax, it shall not be included in the net-wealth of the transferor. Further, if any debt is incurred on the transferred assets by the transferee, and which is payable on the valuation date, it shall be deducted from the value of the transferred assets.

If the transferor transfers an asset which is not an asset (e.g., animals) and the transferee sells such an asset and retains the cash or purchases another asset [which is an asset under the Wealth-tax Act or which is not exempt u/s (5)], the value of such asset on the valuation date shall be included in the net wealth of transferor [M.G. Kollankulam v. CIT (1978) 115 ITR 160 (Ker.)]. Impliedly approving the Kerala High Court’s decision in the case of M.G. Kollankulam (supra), the Supreme Court held in the case of Commissioner of Wealth-tax v. Hashmatunnisa Begum (1989, 176 ITR 98) that the assets transferred by the assessee to his minor daughter did not attract the proviso to Section 4(1)(a) of the Wealth-tax Act and had to be included in her net wealth though the gift was chargeable to gift-tax. The Calcutta High Court’s decision in the case of Commissioner of Wealth-tax v. Sarla Debi Birla (1975, 101 ITR 488) was affirmed. However, any accretion to the asset transferred shall not be included in the net-wealth of transferor [CWT v. T. Saraswati Achi (1980) 125 ITR 186 (Mad.)]. The Madras high Court’s decision in the case of T. Saraswati Achi (supra) had however been dissented from by the Kerala High Court in the case of Commissioner of Wealth-tax v. Smt. T. Rukmini Achi (1987, 166 ITR 715) holding that the bonus shares assumed the character of an accretion. The bonus shares were includible in the net wealth of the assessee subsequent to the re-transfer of the shares. In CWT v. Krishan Mohan (1974) 96 ITR 432, the Delhi High Court has held that where an individual renounced his right to acquire ‘rights shares’ in favour of his minor child/spouse without consideration and the minor child/spouse purchases shares out of own funds, the difference between the market price and the issue price of such shares is not assessable in the hands of transferor individual, since the right to acquire further shares has been exhausted, extinguished and ceased to exist prior to the valuation date of the transfer.

According to Section 4, the following transfers shall be included in the net-wealth of an assessee:

(1) **Assets transferred to spouse [Section 4(1)(a)(i)]**

Assets transferred by an individual to his or her spouse directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart.

In this connection the following points are important:

(a) The asset must be transferred to spouse, i.e., a person who is lawfully wedded and the relationship of spouse must exist on the two dates namely, the date of transfer and the valuation date.

Thus, if the transferor and the transferee were not in the relation of husband and wife on the date of the transfer, but they had merely entered into an agreement to marry, a mere alliance, such a transaction would not attract this clause. Again a divorce terminates the legal relationship between spouses
and, therefore, the transfer between the divorced husband and wife would not be affected by the present sub-clause. The existence of relationship is necessary not only on the date of transfer but also on the valuation date. Thus, if transfer is effected before the marriage is solemnised, or, although the transfer is effected during subsistence of marriage, but on the valuation date such relationship is terminated, then in both the cases, the value of assets cannot be included in the net-wealth of the transferor.

(b) The asset may be transferred directly or indirectly by an individual to the spouse. A direct transfer may be by handling over certain assets to the spouse or by regular deed of conveyance. An indirect transfer may be through a trust or by a cross-transfer.

Thus, if X and Y are father and son, and X transfers certain assets to his daughter-in-law and, in return, thereof, Y transfers his property to his mother, it would really be a case of both X and Y adopting circuitous method to evade tax. In such a case, the veil would be pierced through to expose the real character of the so-called independent transactions and both X and Y would be subject to the operation of this clause [CIT v. C.M. Kothari (1963) 49 ITR 107 SC].

(c) The asset must be transferred without adequate consideration. Love and affection may be a good consideration but it is not adequate consideration. ‘Adequate consideration’ means something more than valid consideration. It must be construed as valuable consideration capable of being compared and measured with money or money’s worth. If the property has been transferred without adequate consideration, the difference between the adequate consideration and inadequate consideration shall be included in the net-wealth of transferor.

(d) If the asset has been transferred under an agreement that husband and wife shall live apart and the agreement is genuine and not sham, the value of the asset transferred shall not be included in the net-wealth of the transferor. The phrase “to live separately” is of wider connotation and even the voluntary agreements to live apart fall within it.

The arrangement in connection with an agreement to live apart may be in both ways. A husband might give his wife moneys for her living apart and similarly the wife may give moneys to her husband for his consent to live apart.

(2) Assets held by minor child [Section 4(1)(a)(ii)]

Assets held by a minor child (not being minor married daughter) of such individual.

The word ‘child’ means a legitimate child or a step child or adopted child but does not include an illegitimate child or grand child or child of any other relative.

The child must be minor on two dates, i.e., the date of transfer and the valuation date. If the child attains majority before the valuation date, the value of the asset held by such child shall not be included in the net-wealth of the assessee.
However, such assets as have been acquired by the minor child out of his income referred to in the proviso to Section 64(1A) of the Income-tax Act (i.e. such income as accrues or arises to the minor child on account of any manual work done by him or any activity involving application of his skill, talent or specialised knowledge, experience etc.) and which are held by him on the valuation date are not be included in computing the net wealth of such individual.

Further, where the assets held by the minor child are to be clubbed with that of his parents, the following rule shall apply:

(a) where the marriage of his parents subsists, in the net wealth of that parent whose net wealth (excluding the assets of the minor child so includible under this sub-section) is greater; or

(b) where the marriage of his parents does not subsist, in the net wealth of that parent who maintains the minor child in the previous year,

and where any such assets are once included in the net wealth of either parent, they will not be included in the net wealth of the other parent unless the Assessing Officer is satisfied after giving that parent an opportunity of being heard that it is necessary so to do.

(3) Assets transferred to a person or association of persons [Section 4(1)(a)(iii)]

Assets transferred by an individual to a person or association of persons after 31.3.56 directly or indirectly, otherwise than for adequate consideration for the immediate or deferred benefit of the transferor, his or her spouse are to be included in net-wealth of the transferor. Here it is important to note that the beneficiary can enjoy either the asset as such or the income of property transferred. Further, in the case of deriving of benefits by the ‘spouse’, relationship of husband and wife between the transferor and beneficiary must exist on the valuation date. Otherwise, the value of the assets transferred shall not be included in the net-wealth of transferor.

However, assets transferred to trust in respect of which gift-tax is chargeable are not includible in computing net wealth of donor - CWT v. H.H. Bhawanisingh (1989) 89 CTR (MP) 134.

(4) Assets transferred under revocable transfers [Section 4(1)(a)(iv)] are included in the net wealth of the transferor. For this purpose, the following transactions are treated as revocable transfers [Clause (b) of Explanation to Section 4]:

(i) transfer revocable within a period of six years or during the transferee’s lifetime; or

(ii) if the transferor derives any benefit, directly or indirectly, from the assets transferred; or

(iii) if the transferor has a right to re-transfer, directly or indirectly, in respect of the whole or any part of the assets or income from the assets to be transferred; or

(iv) if the transferor has the right to re-assume power, directly or indirectly, over the whole or any part of the assets or income from the assets so transferred.
Where a trust is revocable by the donor after ten years, it is irrevocable. [CWT v. Sardar Surjit Singh (1982) 138 ITR 186 (Cal.)].

The property transferred under irrevocable transfer shall be included in the net wealth of the transferor, when he gets the right to revoke the transfer even if he does not revoke the transfer.

Here it must be noted that the irrevocable transfer should not be for the benefit of spouse or minor child of the transferor. It must be for the ‘benefit’ of a person other than spouse or minor child of the transferor.

Assets transferred under points (1) to (4) described hereinabove shall not be included in the net wealth of an individual for any assessment year commencing after 31.3.1964, but before 1.4.1972, if:

(a) the transfer of such assets or any part thereof is chargeable to gift-tax under the Gift-tax Act, 1958, or

(b) the transfer of such assets is exempt under Section 5 of the Gift-tax Act.

From this, it follows that the gifts made prior to the previous year 1963-64 or made after 31.3.1972 shall be chargeable to Wealth-tax under the Wealth-tax Act, 1957, notwithstanding the fact that such gifts have also been chargeable to gift-tax or exempted under Section 5 of the Gift-tax Act.

(5) Assets transferred by an individual to son’s wife or son’s minor child including step child and adopted child [Section 4(1)(a)(v)]

Assets held by son’s wife to whom such assets have been transferred by the individual directly or indirectly on or after 1.6.1973, otherwise than for adequate consideration shall be included in the net wealth of the assessee for wealth-tax purposes. [CWT v. Sushiladevi (1998) 232 ITR 556 (MP)].

(6) Assets transferred by an individual for the benefits of son’s wife [Section 4(1)(a)(vi)]

Directly or indirectly, assets transferred on or after 1.6.1973 without adequate consideration, to a person or an association of persons for the immediate or deferred benefits of the son’s wife are deemed to be the assets of the assessee.

(7) Interest in the assets of the firm, etc. [Section 4(1)(b)]

The value of the partner’s interest in the assets of the firm includible in the net wealth, shall be determined in the manner laid down in Schedule III. Where a minor is admitted to the benefits of partnership in a firm, the value of such minor’s interest, determined as per Schedule III shall be included where the marriage of the parents subsists in the net wealth of that parent of the minor whose net wealth (excluding the minor’s interest) is greater. Once such interest is included in the net wealth of either parent for any assessment year, the same shall not be included in the net wealth of the other parent unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary so to do.
In case the marriage of his parents does not subsist, the value of such minor's interest in the assets of the firm shall be included in the net wealth of that parent who maintains the minor child in the previous year.

(8) Converted Property [Section 4(1A)]

Where an individual who is a member of a Hindu undivided family, converts his individual property after 31.12.69 into property belonging to the family through the act of impressing such separate property with the character of property belonging to the family or throwing it into the common stock of the family, such property is known as converted property and the value of such converted property or any part thereof on the valuation date shall be included in the net-wealth of the individual. Further, any gift made by a member of a HUF, of a separate property or any transfer of property otherwise than for adequate consideration to the family has also to be included in the net-wealth of the individual.

Where the converted property is the subject-matter of partition subsequently amongst the members of the family, the converted property or any part thereof received by the spouse of the individual on such partition shall be deemed to be assets transferred by the individual indirectly to the spouse and the value of such assets shall be included in his net-wealth.

The property, on being included in the net-wealth of the individual, shall be excluded from the net-wealth of the family or spouse as the case may be.

Test Your Knowledge

Which of the following transactions can be treated as revocable transfers?

(a) If the transferor derives any benefit, directly or indirectly.
(b) If the transferor has the right to transfer as gift directly or indirectly.
(c) If the transferor has the right to re-assume power, directly or indirectly.
(d) If the transferor has a right to re-transfer, directly or indirectly.
(e) If the transferor transfers within a period of five years.

Correct answer: (a), (c), (d)

(9) Transfer by means of entries in the books [Section 4(5A)]

Where a gift of money from one person to another is made by means of entries in the books of account maintained by any one or more of the following persons:

(a) the donor;
(b) an individual with whom the donor has business or other relationship; and
(c) a Hindu undivided family or a firm or an association of persons or body of individuals with which the donor has business connection, the amounts so gifted shall be included in the net wealth of the donor. However, if the donor
can prove to the satisfaction of the Wealth-tax Officer that simultaneous to the making of the book entry, money is actually handed over to the donee in the physical sense, the money so gifted shall not be included in the net-wealth of the donor.

(10) Impartible estate [Section 4(6)]

Although under the general law the Hindu undivided family is the owner of the properties in an impartible estate, for the purpose of Wealth-tax Act, the holder is deemed to be the individual owner of that estate and accordingly liable to include the value of all properties comprised in the estate in his individual net-wealth.

(11) House from a co-operative housing society [Section 4(7)]

Where the assessee is a member of a co-operative housing society and a building or part thereof is allotted or leased to him under a house building scheme of the society, the assessee shall be deemed to be the owner of such building or part thereof and the value of such building shall be included in the net-wealth of the assessee. For determining the value of such building, any outstanding amount payable by the assessee to the society towards the cost of such building or part thereof and the land appurtenant thereto shall be deducted as a debt owed by him in relation to such building.

While including the above assets under Section 4, the following points must be considered:

(a) The asset need not be in the same form in which it was transferred by the transferor.

(b) Though Section 4 covers ‘direct’ and ‘indirect’ transfers, accretions to the assets transferred do not come within the scope of Section 4. Hence, as held in the case of CWT v. Saraswathi Achi (1980) 4 Taxman 356 (Mad.) though the value of equity shares gifted by an assessee to his wife is taxable in his hands, value of bonus shares allotted to wife is not includible as an asset of the donor.

(c) The phrase ‘individual’ has to be interpreted to mean both man and woman.

10.5.3 ASSETS EXEMPT FROM WEALTH-TAX

Under Section 5, wealth-tax shall not be payable by an assessee in respect of the following assets and such assets shall not be included in the net wealth of the assessee.

(i) Property held under a Trust [Section 5(1)(i)]

Any property held by the assessee under a trust or other legal obligation for any public purpose of a charitable or religious nature in India.

For exemption under this clause three conditions must be satisfied:

(a) The property must be held by him under a trust or other legal obligation for the stated purposes. However, the property of the trust should not be used for the benefit of the donor or the family members of such person.
(b) The property must be for a public charitable purpose or a public religious purpose. The expression “charitable purpose” means relief of the poor, educational or medical relief or the advancement of any other object of general public utility, and “religious purpose” means any purpose related to the advancement, support or propagation of religion.

(c) The property of the trust must be used in India. If the trust is situated in India but the property is used outside India, the property shall not be exempt from tax.

In a case where the deed did not provide specifically that the income of the trust should be spent in India but there was nothing on record to show that any part of the income was spent outside India, it was held that the exemption cannot be denied. [Trustees of H.E.H. The Nizam’s Sahebzadas of Sarf-E-Khas Trust v. C.W.T. (1981) 127 ITR 694 (A.P.)].

By virtue of amendment of Section 5(1)(i) from the assessment year 1986-87, exemption from wealth-tax in respect of business assets of public charitable or religious trusts and institutions has been withdrawn. Consequently, w.e.f. assessment year 1986-87, only the following assets, as provided in the Income-tax Act will be exempt from wealth-tax:

(a) where the trust carried on business wholly for public religious purposes and the business consists of: (i) printing and publication of books; or (ii) publication of books; or (iii) is of a kind notified by the Central Government in this behalf in the Official Gazette.

(b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is carried on mainly for the beneficiaries of the institution; and separate books of account are maintained by the trust or institution in respect of such business.

(c) an institution, fund or trust referred to in clause (22) or (22A) or (23B) or (23C) of Section 10 of the Income-tax Act carries on the business.

However, exemption in respect of property forming part of business of an educational institution or a hospital entitled to exemption under Section 10 (22)/10(22A) of the Income-tax Act, would be available, only if such institution satisfy conditions of Section 11(4A) of the Income-tax Act.

(ii) Interest in the coparcenary property of the HUF [Section 5(1)(ii)]

The interest of the assessee in the coparcenary property of any H.U.F. of which he is a member. However, on this property the family is liable to pay tax. This exemption is available to the assessee only so long as the property remains joint and he continues as a member of that family. As soon as a partition is effected, the share allocated to a member becomes his personal property and after that he would be liable to pay tax on his share.

(iii) One official residence of the Ruler [Section 5(1)(iii)]

As per Section 5(1)(iii), any one building in the occupation of a former ruler of a princely state which has been declared by the Central Government as his official residence immediately before the commencement of the Constitution (Twenty Sixth Amendment) Act, 1971. If a Ruler has several
official residences, out of them exemption is available in respect of one alone. The choice of this one residence was left to the Ruler, who accordingly conveyed his option to the Board. Further, the exemption of building in full value can be enjoyed by the Ruler during his life time. After the death of the Ruler the successor cannot enjoy the benefit of the exemption. It must be noted that the exemption is granted only in respect of those buildings or places which were occupied by the Ruler and not in respect of buildings let-out to tenants - Mohd. Ali Khan v. CWT (1983) 12 Taxman 330 (Delhi).

(iv) Hireloom Jewellery of an earstwhile ruler [Section 5(1)(iv)]

Jewellery in the possession of any Ruler (excluding his personal property) which has been recognised before the commencement of the Wealth-tax Act, by the Central Government, as his heirloom or by the Central Board of Direct Taxes, hereinafter referred to as “Board” as his heirloom at the time of his first assessment to wealth-tax under Wealth-tax Act. The recognition of the jewellery shall be subject to the following conditions:

(a) that the jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board;

(b) that reasonable steps shall be taken for keeping jewellery substantially in its original shape;

(c) that reasonable facilities shall be allowed to the authorised person to examine the jewellery as and when necessary.

If the assessee fails to fulfil any of the above conditions, the Board after recording the reasons in writing, may withdraw retrospectively with effect from the date of commencement of the Rulers of Indian States (Abolition of Privileges) Act, 1972 and wealth-tax shall become payable by the assessee for all the assessment years for which the jewellery was exempted on account of the recognition. However, the wealth-tax payable on the valuation date relevant to the assessment year in which the recognition was withdrawn shall not exceed 50 per cent of the fair market value of such jewellery.

(v) Money and the assets brought into India by Citizen of India or person of India Origin [Section 5(1)(v)]

An assessee being a person of Indian origin or a citizen of India who was ordinarily residing in a foreign country and who, on leaving such country, has returned to India with the intention of permanently residing therein, moneys and the value of assets brought by him into India and the value of the assets acquired by him out of such money. (Within one year immediately preceding the date of his return and at any time thereafter). However, this exemption shall be available for a period of 7 successive assessment years commencing with the assessment year next following the date on which such person returned in India.

For the purpose of this clause, a person shall be deemed to be of Indian origin if he or either of his parents or any of his grand-parents, was born in
undivided India. Moneys standing to the credit of such persons, in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999, and any rules made thereunder, on the date of his return to India, shall be deemed to be moneys brought by him into India on that date.

(vi) One House or part of the house [Section 5(1)(vi)]

One house or part of a house belonging to an individual or a Hindu Undivided Family; or a plot of land comprising an area of five hundred square meters or less.

A cinema hall cannot be treated as a house as per Section 5(vi), as was decided in the case CIT v. Jai Kishen Gupta (2004) 137 Taxman 388 (All.).

10.5.4 Debts and Liabilities

What is debt?

The word debt is not defined under the Act. But in the very nature of things, the deductible debt or liability must be "external" to the concerned assessee, that is to say in favour of other persons, or parties. In other words, from the "liabilities side" of his Balance Sheet, his own capital, reserves and the profit and loss a/c credit balance etc., must be ignored altogether.

In order to compute the net-wealth of the assessee, the aggregate value of the debts and liabilities which are legally enforceable against him on the valuation date must be deducted from the aggregate value of the assets. Further, the liabilities which have matured into debts payable at present or in future are deductible.

The most important thing of course is that the debt or liability in question must have been incurred specifically in relation to the taxable asset. While bank overdraft taken for meeting the working capital requirements will therefore not be deductible.

In computation of the net wealth of an assessee under section 2(m), any debt secured on the secrity of an asset which is entirely and completely excluded in computation of wealth tax shall not be deducted. When a debt is secured on secured on several items of properties one of which alone is exempted, that portion of the debt which attributable to the value of the property exempted from wealth tax can not be deducted in the computation of the net wealth of the assessee [CIT v. Vaidyanathan (K.S ) (1985) 153 ITR 11 (Mad)].

The following debts are not deductible:

(i) Debts located outside India, in case of non-citizens of India and an individual or a Hindu Undivided Family who is a non-resident or not ordinarily resident in India. These debts are not taken into account because in these cases the assets located outside India are also to be ignored.

(ii) Debts secured on or incurred in relation to the non-taxable assets i.e. assets for which exemption is available under Section 5 or assets which do not fall within the definition of the term in Section 2(ea).

10.5.5 Location of Assets and Debts

The determination of location of assets and debts is necessary for the following
three reasons:

(i) The assets and debts located outside India and belonging to non-citizens are not included in the net-wealth.

(ii) Payment of tax may be held in abeyance where the assets taken into account for assessment are located outside India in cases where the laws of that country prohibit or restrict the remittance of money to India.

(iii) Tax rebate is granted to an individual and a H.U.F. in respect of their assets located outside India.

Though the question as to where an asset is located is essentially one of fact and will have to be determined in the light of evidence, guidelines, as follows, may be used for the purpose:

(a) **Tangible Immovable Property:** The location of the tangible immovable property (land, buildings, lakes, etc.) is in India, if it is physically situated in India.

(b) **Intangible Immovable Property:** Rights or interest in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India if the immovable property to which the rights are attached or out of which the benefits arise, lies in India.

Examples of rights and interests are easements of light and air, right of way, ferry, right of fishery, etc.

Examples of benefits arising out of immovable property are: right to collect market dues at a fair held on a plot of land; right to levy tolls; right to use water of a lake or tank for irrigation; right to collect lac from trees; etc.

(c) **Movable Property:** Right or interests (otherwise than by way of security) in or over tangible movable property are located in India if such property is located in India.

However, the supreme Court has held that the goods on high seas, while in transit to India, are located outside India, since the high seas cannot be considered as a part of India in the absence of anything in the Act making a part of India [C.W.T. v. Consolidated Pneumatic Tools Co. Ltd. (1971) 81 ITR 752].

(d) **Debts:** Debts, secured or unsecured are located in India if they are contracted to be repaid in India and where the place of repayment is not specified, if the debtor is residing in India. The circumstance that the documentary evidence of the debt is situated in a country different from the country of residence of the debtor is immaterial.

(e) **Ship or Air Crafts:** They are located in India if they are registered in India.

For assets which are covered by the above items, the location shall be determined having regard to the nature of the assets.

### 10.5.6 Valuation of Assets

Wealth-tax is charged on the net-wealth of the assessee, therefore, it is an important function of the Assessing Officer to determine the value of the assets held...
by the assessee on the valuation date. Section 7 lays down the method of its
determination, the value of any asset, other than cash, shall be the value thereof
determined in the manner laid down in Schedule III.

(A) Valuation of immovable Property

The valuation of immovable property is given in Part B of Schedule III of the
Wealth tax Act.

Steps for Valuation of immovable property:

1. Determine annual rent.
2. Calculate Gross maintainable rent.
3. Calculate Net Maintainable Rent.
4. Capitalise Net Maintainable Rent as per the given formula in Rule 3.
5. Now make adjustments for unbuilt area of plot of land
6. Then adjust for unearned increase in the value of the land.
7. At last compare the value derived with actual cost of construction as given
   below in (g) to determine the value to be taken for wealth tax purpose.

(a) Determination of Annual Rent:

Annual Rent is equal to: Actual rent received or receivable (including all
payments /benefits/perquisites paid by the tenant for the use of the property in any
form or name) (if property is let out throughout the year ending on the valuation date)

Or

Actual rent received or receivable (including all payments /benefits/perquisites
paid by the tenant for the use of the property in any form or name) × 12 ÷ Number of
Months for which the property is let out (if property is let for only a part of the year
ending on the valuation date)

Add:

- Local taxes paid by the tenant
- 1/9th of the actual rent (if repairs expenditure is borne by the tenant)
- 15% p.a. on deposit held by the owner for the number of the months
  (excluding part of a month) in the previous year (but it does not include
  advance rent for a period not exceeding three months and the interest to
  be paid by the owner will be deducted from this amount)
- (Amount received for lease/ the number of years of the period of the
  lease) If the owner has received any amount by way of premium for
  leasing of the property.
- Any benefit or perquisite derived by the owner in consideration for leasing of the
  property or any modification of the terms of the lease.
(b) Computation of Gross maintainable rent (GMR) (Rule 5):

**IMMOVABLE PROPERTY**

- **IS LET OUT**
  - GMR = Higher of following two:
    - Annual rent received or receivable
    - Annual value assessed by the local authority for the purposes of levy of property tax or any other tax

- **IS NOT LET OUT**
  - GMR = Annual rent assessed by the local authority for the purposes of levy of property tax or any other tax.
  - OR
  - The expected annual rent if such property has been let out. It will be used only if assessment cannot be made by the authority or such property is situated outside the area of any local authority.

(c) Calculation of Net Maintainable Rent (Rule 4):

Gross maintainable rent

Less: Taxes levied by any local authority in respect of the property

15% of gross maintainable rent

Net maintainable rent

(d) Value of any immovable property (Rule 3):

Value of any immovable property = Net maintainable rent × (12.5)

Value of any immovable property which is constructed on leasehold land:

- And the unexpired period of the lease ≥ Fifty years
  - Value of any immovable property = Net maintainable rent × (10)

- And the unexpired period of the lease < Fifty years
  - Value of any immovable property = Net maintainable rent × (8)

(e) Adjustments for unbuilt area of plot of land (Rule 6):

If the unbuilt area of the plot of land on which the property is constructed > the specified area, add following amount to the value of immovable property:
Meaning of terms used:

- **Aggregate area** means the aggregate of the area on which the property is constructed and the unbuilt area.
- **Unbuilt area** means that part of such aggregate area on which no building has been erected.
- **Specified area** means where the property is situated at:
  - Mumbai, Kolkata, Delhi or Chennai: 60% of the aggregate area
  - Agra, Ahmedabad, Allahabad, Amritsar, Bangalore, Bhopal, Cochin, Hyderabad, Indore, Jabalpur, Jamshedpur, Kanpur, Lucknow, Ludhiana, Madurai, Nagpur, Patna, Pune, Salem, Sholapur, Srinagar, Surat, Tiruchirapalli, Trivandrum, Vadodara (Baroda) or Varanasi (Benaras): 65% of the aggregate area
  - At any other place: 70% of the aggregate area
- Specified area shall be the minimum area when such minimum area is kept as open space for the enjoyment of the property under any law for the time being in force and such minimum area is greater than the specified area.

Where the difference between the unbuilt area and the specified area is:

- More than 5% but does not exceed 10% of the aggregate area: Add 20% of the value of immovable property calculated;
- More than 10% but does not exceed 15% of the aggregate area: Add 30% of the value of immovable property calculated;
- More than 15% but does not exceed 20% of the aggregate area: Add 40% of the value of immovable property calculated;
(f) Adjustment for unearned increase in the value of the land (Rule 7):

It is applicable when:

(a) The property is constructed on land obtained on lease from
   • the Government,
   • a local authority or
   • any authority referred to in clause (20A) of section 10 of the Income-tax Act,

   and

(b) The Government or any such authority is entitled to claim and recover a specified part of the unearned increase in the value of the land at the time of the transfer of the property, under the terms of the lease.

The value of such property

Value of property as determined under Rule 3 after making adjustment for unbuilt area of plot if any XXX

Less: Lower of the following two

- Amount equal to 50% of the value of the property as determined above XXX
- Amount liable to be claimed and recovered by the Government for unearned increase XXX

where, unearned increase = (value of such land on the valuation date as determined by the Government or authority - amount of the premium paid or payable to the Government or such authority for the lease of the land)

(g) Now compare the value derived with actual cost of acquisition, if the property is acquired or construction of property is completed after the 31/03/1974. The value of such property will be higher of following:

- Value derived above after all the adjustments.
- Actual cost of acquisition/construction and cost of improvement.

This clause will not be applicable for:

- Only one residential house exclusively used for his own residential purposes throughout the period of 12 months immediately preceding the valuation date

   and

- If the actual cost of acquisition/construction plus cost of improvement, does not exceed,—

If the house is situated at Mumbai, Kolkata, Delhi or Chennai.

- FIFTY LAKH RUPEES

If the house is situated at any other place.

- TWENTY FIVE LAKH RUPEES
(h) Non applicability of Rule 3 (Rule 8):

The valuation of immovable property in following cases shall be determined in the manner laid down in Rule 20.

- Where, having regard to the facts and circumstances of the case, the Assessing Officer, with the previous approval of the Deputy Commissioner, is of opinion that it is not practicable to apply the provisions of the said rule to such a case; or
- Where, (unbuilt area - specified area) > 20% of the aggregate area; or
- Where, the immovable property is constructed on leasehold land and the lease is for a period ≤ 15 years from the relevant valuation date and there is no provision for the renewal of the lease.

Test Your Knowledge

Which of the following falls under the specified area?

(a) The property situated at Agra, Ahmedabad, Allahabad, Amritsar, 60% of the aggregate area
(b) The property situated at Mumbai, Kolkata, Delhi or Chennai, 60% of the aggregate area
(c) The property situated at Salem, Sholapur, Srinagar, Surat, 70% of the aggregate area
(d) The property situated at Jamshedpur, Kanpur, Lucknow, Ludhiana, 70% of the aggregate area.

Correct answer: (b)

(B) Valuation of assets of business

The valuation of immovable property is described in Part D of Schedule III of the Wealth tax Act. As per Rule 14(1), for the assessee who is carrying on a business and has maintained accounts regularly, the value of Net Assets (Total Assets minus Total liabilities) will be calculated on the basis of Balance Sheet of the assessee to determine the value of business, subject to the conditions mentioned under Rule 14(2).

Following are the conditions mentioned in Rule 14(2):

(i) The value of the asset will be the value as disclosed in the balance-sheet. The depreciable assets will be valued at written-down value, Non depreciable assets at book value and the Closing stock value will be as adopted under the Income-tax Act.

(ii) If the value of asset as determined under Rule 14(2)(a) exceeds the value calculated under Schedule III of this Act by more than 20%, then the higher value shall be taken to be the value of that asset.
(iii) If the value of an asset is not disclosed in the balance-sheet, determine the value under Schedule III of this Act.

**Assets not to be Included: [Rule 14(2)(d)]**

Following assets even if disclosed in the balance sheet shall not be included in calculating the Value of Assets of Business:

(i) Advance tax paid under the Income-tax Act;

(ii) the debt due to the assessee according to the balance-sheet or part thereof which has been allowed as a deduction under clause (vii) of sub-section (1) of section 36 of the Income-tax Act, for the purposes of assessment for the previous year relevant to the corresponding assessment year under that Act;

(iii) The value of any asset in respect of which wealth-tax is not payable under this Act;

(iv) Any amount shown in the balance-sheet including the debit balance in the profit and loss account or profit and loss appropriation account which does not represent the value of any asset;

(v) Any asset shown in the balance-sheet not really pertaining to the business;

**Liabilities not to be Considered: [Rule 14(2)(e)]**

Following amounts shown as liabilities in the balance-sheet shall not be considered:

(i) Capital employed in the business other than that attributable to borrowed money;

(ii) Reserves by whatever name called except provision for taxation;

(iii) Any provision made for meeting any future or contingent liability;

(iv) Any liability shown in the balance-sheet not really pertaining to the business;

(v) Any debt owed by the assessee to the extent to which it has been specifically utilised for acquiring an asset in respect of which wealth-tax is not payable under this Act. Provided that where it is not possible to calculate the amount of debt so utilised, it shall be taken as the amount which bears the same proportion to the total of the debts owed by the assessee as the value of that asset bears to the total value of the assets of the business.

**(C) Valuation of interest in firm or association of persons**

The Part E of the Schedule III of the Wealth Tax Act deals with the Valuation of Interest in firm or association of persons. As per Rule 15 the value of the interest of a person in a firm of which he is a partner or in an association of persons of which he is a member shall be determined in the manner provided in Rule 16.

**STEP 1:** The net wealth of the firm or association of persons on the valuation date shall first be determined as if it were the assessee.

**STEP 2:** The portion of the net wealth of the firm or association, as is equal to the
amount of its capital shall be allocated among the partners or members in the proportion in which capital has been contributed by them.

STEP 3: The residue shall be allocated amongst the partners or members in accordance with the agreement of partnership or association for distribution of assets in the event of dissolution of the firm or association.

STEP 4: In absence of such agreement, the apportionment of net wealth shall be done in the proportion in which the partners or members are entitled to share the profits.

STEP 5: The sum total of the amounts so allocated to the partner/member under steps 2 to 4 shall be taken as the value of interest of that partner or member in the firm or association.

Test Your Knowledge

Which is the next step that you follow after the net wealth of the firm or association of persons on the valuation date is determined?

(a) Net wealth equal to the amount of its capital is allocated among the partners.

(b) Residue is allocated amongst the partners or members in accordance with the agreement of partnership.

(c) Apportionment of net wealth is done in the proportion in which the partners or members are entitled to share the profits.

(d) The sum total of the amounts allocated to the partner is taken as the value of interest of that partner.

Correct answer: (a)

(D) Valuation of life interest

According to the Rule 17(1) (Part F of Schedule III), the value of the life interest of an assessee is—

\[
\text{Value of life interest} = \left( \frac{\text{Average annual income accrued to the assessee from the life interest}}{1/(p+d)-1} \right)
\]

Where,

\[ p = \text{the annual premium for a whole life insurance without profits on the life of the life tenant for unit sum assured as specified in the Appendix to these rules} \]

\[ d = i / (1+i), \ i \text{ is the rate of interest.} \]

\[ i = 6\frac{1}{2} \% \text{ per annum} \]

Average annual income\(=\) (Average gross annual income) – (Average Expenses incurred on collection of such income)
Average annual gross income = \( \frac{\text{Total gross income from the life interest}}{\text{Total number of years}} \)

Average Expenses = \( \frac{\text{Total expenses incurred on the collection of such income}}{\text{Total number of years}} \)

Note:
- Average expenses incurred on collection of such income shall not exceed 5% of the average annual gross income.
- Average annual income will be calculated only for the period of maximum 3 years preceding the period ending on the valuation date.
- The Assessing Officer may vary the normal premium rates in force and determine value accordingly if he thinks that the normal rates are low or any insurance company would not provide insurance at that premium.
- The value of the life interest determined above shall not be greater than the value of the corpus of the trust determined under schedule III of this Act.

(E) Valuation of Jewellery (Part G of Schedule III)

The value of the jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date i.e. the fair market value. The return of net wealth furnished by the assessee shall be supported by,—

- a statement in the prescribed form (if the value of jewellery ≤ 500,000)
- a report of a registered valuer in the prescribed form (if the value of jewellery > 500,000)

The Assessing Officer (AO) may refer the valuation of jewellery to a Valuation Officer under Section 16A(1) and the value of such jewellery shall be the value as estimated by the Valuation Officer, if AO is of the opinion that:

- The value of the jewellery declared in the return < fair market value by such percentage as is prescribed under Section 16A(1)(b)(i) of the Act;
- The value of the jewellery declared in the return < fair market value.

The value of jewellery so estimated by the Valuation Officer shall be taken to be the value of such jewellery for the subsequent 4 (four) assessment years, subject to the following adjustments:—

- where the jewellery includes gold or silver or any alloy containing gold or silver, the value of such gold or silver or such alloy as on the valuation date relevant to the concerned subsequent assessment year shall be substituted for the value of such gold or silver or alloy on the valuation date relevant to the first assessment year;
- where any jewellery or part of jewellery is sold or otherwise disposed of by the assessee, or any jewellery or part of jewellery is acquired by him, on or before the valuation date relevant to the concerned subsequent
year, the value of the jewellery determined for the first assessment year shall be reduced or increased, as the case may be, and the value as so reduced or increased shall be the value of the jewellery for such subsequent assessment year.

(E) Valuation of assets in other cases (part H of Schedule III)

The value of any asset, other than cash, not covered by above schedules shall be the fair market value as in the opinion of the Assessing Officer on the valuation date.

If the valuation of any asset is referred by the Assessing Officer to the Valuation Officer under section 16A, the value of such asset, shall be the fair market value as in the opinion of the valuation officer on the valuation date.

If the value of any asset cannot be estimated under this rule because it is not saleable in the open market, the value shall be determined in accordance with such guidelines or principles as may be specified by the Board from time to time by general or special order.

The price or other consideration for which any property may be acquired by or transferred to any person under the terms of a deed of trust or through or under any restrictive covenant in any instrument of transfer shall be ignored for the purposes of determining value under any provision of this Schedule and the price of such property would be the price the property would fetch if sold in the open market on the valuation date.

10.5.7 Rounding off of Net-wealth

Under Section 44C, the net-wealth computed under the provisions of the Act shall be rounded off to the nearest multiple of ₹ 100. If the amount contains a part of one hundred rupees and if such part is fifty rupees or more, the amount shall be increased to the next higher amount which is multiple of hundred. If such part is less than fifty rupees, the amount shall be reduced to the next lower amount which is a multiple of one hundred. The amount so rounded off shall be deemed to be the net-wealth of the assessee.

Rounding off of Tax, Interest, Penalty etc. (Section 44D)

The amount of wealth-tax, interest, penalty, fine or any other sum payable or refundable under the Act shall be rounded off to the nearest rupee. If the amount contains a part of rupee, then, if such part is fifty paise or more, it shall be increased to one rupee and if such part is less than fifty paisa it shall be ignored.

ILLUSTRATIONS

Illustration 1: Ram owns a house which is constructed on leasehold land acquired from DHA(Delhi Housing Authority).

This house has been let out to Shyam for ₹ 15000 per month under following terms and conditions:

- He will pay 40% of the municipal taxes and bear cost of repairs.
- He is also required to give advance of ₹ 200,000 which will be interest
He will pay the premium for leasing the property for five years of amount Rs. 100,000.

Other Informations:
- The annual value assessed by the local authority is ₹ 1,50,000
- Local taxes levied are ₹ 15,000.
- Expenditure on repairs by Shyam ₹ 20,000
- Difference between aggregate area and unbuilt area is 16% of the aggregate area.
- Cost of building including land in 1985 was ₹ 10,00,000
- DHA’s current value of land is ₹ 500,000 and it charges 50% of the unearned increase on the transfer of a house.
- Ram acquired land for ₹ 90000 from DHA.
- Unexpired period of lease is 90 yrs.

Compute the value of house property for the purpose of wealth tax of Ram.

Solution:

Computation of value of house property for Ram

Step 1: Determination of annual rent received

Actual rent received \( (15,000 \times 12) \) 180,000

Add:
- Municipal tax paid by tenant (40% of 15,000) 6000
- Repairs \( \frac{1}{9} \)th of 180,000 20,000
- Interest on deposit (15% of 2,00,000) 30,000
- Premium on lease (100,000/5) 20,000

Annual rent received 2,56,000

Step 2: Calculation of GMR

Annual rent received 2,56,000

Annual value assessed by the authority 1,50,000

GMR (higher of above two) 2,56,000

Step 3: Calculation of NMR:

GMR 2,56,000

Less:
- Taxes levied by local authority 15,000
- 15% of GMR (15% of 2,56,000) 38,400

NMR 2,02,600
Step 4: Capitalised value of immovable property

Capitalised value = \( NMR \times 10 \)

= 2,02,600\*10

= 20,26,000

Step 5: Adjustment for unbuilt area of land

Capitalised value

Add:

30% of Capitalised value as premium

Value of immovable property after adjustment for unbuilt area of land

Step 6: Adjustment for unearned increase

Value of immovable property after adjustment for unbuilt area of land

Less:

50% of Value of immovable property (26,33,800) or

Amount liable to be recovered by authority for unearned increase (50% of 500,000 − 90,000)

Lower of above two

Value of immovable property after adjustment for unearned increase

Step 7: The property is acquired after 31/03/1974, therefore the value of property will be higher of value determined above (₹ 24,73,800) and actual cost of acquisition (₹ 10,00,000).

Therefore value of house property for wealth tax of Ram is ₹ 24,73,800.

Illustration:

A owns a house property which is situated at Delhi and is used for residential purposes throughout the year. The annual value of the property as per the municipal records is ₹ 1,00,000, whereas the rent received from the tenant is ₹ 80,000. The municipal taxes are paid partly by A (₹ 3,000) and partly by the tenant (₹ 5,000). The tenant bears the entire repair expenses of ₹ 5,000. He also deposited with the landlord a sum of ₹ 25,000 as refundable security which, however, does not carry any interest. The difference between ‘unbuilt area’ and ‘specified area’ does not exceed 5 per cent. What will be the value of the house property on March 31, 2011 if (i) the house is built on freehold land; (ii) it was acquired later than April 1, 1975, for ₹ 10,00,000; and (iii) the cost of improvement is ₹ 20,000.
Solution:

**Computation of Value of House Property as on 31st March 2012**

<table>
<thead>
<tr>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GROSS MAINTAINABLE RENT</strong></td>
<td></td>
</tr>
<tr>
<td>(a) Annual value, i.e. the municipal valuation of the property</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(b) Annual Rent</td>
<td></td>
</tr>
<tr>
<td>— Actual rent paid by the tenant</td>
<td>80,000</td>
</tr>
<tr>
<td>— Add: one ninth of ₹ 80,000 as repair expenses borne by the tenant</td>
<td>8,888</td>
</tr>
<tr>
<td>— Municipal taxes borne by the tenant</td>
<td>5,000</td>
</tr>
<tr>
<td>— Interest @ 15% on deposit of ₹ 25,000</td>
<td>3,750</td>
</tr>
<tr>
<td>Gross Maintainable rent, being the higher of Municipal Valuation and Annual Rent</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

**Less:** Municipal Taxes (₹ 3,000 + ₹ 5,000) | (–) 8,000 |
15% of ₹ 1,00,000 | (–) 15,000 |

**NET MAINTAINABLE RENT**

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>77,000</td>
</tr>
</tbody>
</table>

**CAPITALISED VALUE**

Property constructed on freehold land (77,000 × 12.5) Value of property : 9,62,500

Since the property is acquired after 1.4.1975, its value will be ₹ 10,00,000 + ₹ 20,000 i.e. 10,20,000. But, since it is used for residential purposes throughout the period of 12 months preceding the valuation date, the rule of substitution of actual cost of construction/improvement will not apply. Therefore, the value of property shall be ₹ 9,62,500.

**Illustration:**

Jolly has the following assets and liabilities on the valuation date i.e., 31st March, 2012:

<table>
<thead>
<tr>
<th>₹ in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) Residential house</td>
</tr>
<tr>
<td>ii) A farm house — 15 kms. away from the local limit of Calcutta</td>
</tr>
<tr>
<td>iii) Car for personal use</td>
</tr>
<tr>
<td>iv) Jewellery</td>
</tr>
<tr>
<td>v) Air craft for personal use</td>
</tr>
<tr>
<td>vi) Urban land (construction is not permitted under the law)</td>
</tr>
<tr>
<td>vii) Cash in hand</td>
</tr>
<tr>
<td>viii) Loan taken to purchase the air-craft</td>
</tr>
</tbody>
</table>

Compute the net-wealth of Jolly for the assessment year 2012-13.
Solution:

Computation of net-wealth of Jolly
for the assessment year 2012-13

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Residential house exempt under Section 5(vi)</td>
<td>—</td>
</tr>
<tr>
<td>(ii) Farm House*</td>
<td>30.00</td>
</tr>
<tr>
<td>(iii) Car for personal use</td>
<td>16.00</td>
</tr>
<tr>
<td>(iv) Jewellery</td>
<td>24.00</td>
</tr>
<tr>
<td>(v) Aircraft for personal use</td>
<td>180.00</td>
</tr>
<tr>
<td>(vi) Urban land [construction is not permitted under the law, hence not an asset under Section 2(ea) of the Wealth-tax Act, 1957]</td>
<td>—</td>
</tr>
<tr>
<td>(vii) Cash in hand (in excess of ₹ 50,000 is an asset)</td>
<td>10.50</td>
</tr>
</tbody>
</table>

Gross Wealth 260.50

Less: Loan taken to purchase the aircraft (80.00)

Net Wealth 180.50

10.6 RETURN OF WEALTH

(1) Voluntary Return

The procedure under the Wealth-tax Act for making the assessment of net wealth begins with the filing of a return of wealth. Section 14 of the Act contains the relevant provisions relating to the filing of return of Wealth. According to that section it is statutorily obligatory for every person, if his net wealth or the net wealth of any other person in respect of which he is assessable under this Act on the valuation date exceeded the maximum amount which is not chargeable to wealth-tax, shall, on or before the due date, furnish a return of his net wealth or the net wealth of such other person as on that valuation date in the prescribed form and verified in the prescribed manner setting forth particulars of such net wealth and such other particulars as may be prescribed.

Explanation: Sub-section(1) specifies the "due date" in relation to an assessee under the Wealth-tax Act, to be the same date as that applicable to an assessee under the Income-tax Act under the Explanation to Sub-section (1) of Section 139 of the Income-tax Act, i.e.,

(a) Where the assessee is a company, the 30th day of September of the assessment year;

(b) Where the assessee is a person, other than a company:

(i) in a case where the accounts of the assessee are required under the Income Tax Act or any other law to be audited or in the case of a partner of a firm where the accounts of the firm are required to be so audited, or, in the case of a co-operative society, the 30th day of September of the assessment year;

* Note: A farm house situated within 25 kilometers from the local limits of any municipality or a cantonment board is treated as an 'asset' under Section 2(ea) of the Wealth-tax Act, 1957.
(ii) in a case where the total income referred to in Sub-section (1) of Section 139 includes any income from business or profession, not being a case falling under Sub-clause (i) hereinabove, the 31st day of July of the assessment year;

(iii) in any other case, the 31st day of July of the assessment year.

However, notwithstanding anything contained in any other provisions of the Wealth-tax Act, a return of net wealth which shows the net wealth below the maximum amount which is not chargeable to tax shall be deemed to have never been furnished.

It is further provided that Sub-section (2) shall not apply to a return furnished in response to a notice under Section 17;

(2) Return after Due Date and Amendment of Return (Section 15)

If any person has not furnished a return within the time allowed under Section 14(1) or under a notice issued under Section 16(4)(i), or having furnished a return discovers any omission or a wrong statement therein, he may furnish a belated return or revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier.

An assessment is made or completed when the order of assessment is signed by the Assessing Officer, and not when the assessment order or notice of demand is served on the assessee. If the assessee files the belated return or revised return before the assessment is made, the Assessing Officer is bound to consider such return and he cannot assess the assessee under Section 17 (wealth escaping assessment).

Return by whom to be signed (Section 15A)

The return of wealth must be signed and verified:

(a) In case of an individual:
   (i) by individual himself;
   (ii) where the individual is absent from India, by the individual concerned or by a person duly authorised by him;
   (iii) where the individual is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf;
   (iv) where for any other reason it is impossible for the individual to sign the return, by any person competent to act on his behalf.

(b) In case of Hindu undivided family:
   (i) by the Karta;
   (ii) where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of the family; and

(c) In the case of a company:
   (i) by the Managing Director of the company;
   (ii) where the Managing Director, because of any unavoidable reason could
not sign the return, or where there is no Managing Director, by any
Director thereof.

(iii) where the company is being wound up, whether under the orders of the
Court or otherwise, or where any person has been appointed as the
receiver of any assets of the company, the return has to be signed and
verified by the liquidator referred to in Section 178(1).

(iv) where the management of the company has been taken over by the
Central Government or any State Government under any law, the return
has to be signed and verified by the principal officer thereof.

(v) where the company is not resident in India the return may be signed and
verified by any person who holds a valid power of attorney from such
company to do so, which shall be attached to the return.

10.7 ASSESSMENT

(1) Self Assessment [Section 15B]

Where any tax is payable on basis of any return furnished under Section 14 or
Section 15 or in response to a notice under clause (i) of Sub-section 4 of Section 16
or under Section 17, after taking into account the amount of tax, if any, already paid
under any provision of this Act, the assesse shall be liable to pay such tax, together
with interest payable under any provision of this Act for any delay in furnishing the
return, before furnishing the return and the return shall be accompanied by proof of
payment of such tax and interest.

Where the amount paid by the the assesse under Sub-section (1) (as above),
falls short of the aggregate of the tax and interest as aforesaid, the amount so paid
shall first be adjusted towards the interest payable as aforesaid and the balance, if
any, shall be adjusted towards the tax payable.

After the regular assessment under Section 16 has been made, any amount paid
under Sub-section (1) shall be deemed to have been paid towards such regular
assessment.

If any assesse fails to pay the whole or any part of such tax or interest or both in
accordance with the provisions of Sub-section (1), he shall, without prejudice to any
other consequences which he may incur, be deemed to be an assesse in default in
respect of the tax or interest or both remaining unpaid and all the provisions of this
Act shall apply accordingly.

(2) Assessment

Section 16, provides for assessment, as follows:

(1) Where a return has been made voluntarily or after due date or in response to
a notice under clause (i) of Sub-section (4), -

(i) if any tax or interest is found due on the basis of such return after
adjustment of any amount paid by way of tax or interest, an intimation
shall be sent to the assesse specifying the sum so payable, and such
intimation shall be deemed to be a notice issued under Section 30 and
all the provisions of the Act shall apply accordingly; and
(ii) if any refund is due on the basis of such return, it shall be granted to the
assessee and an intimation to this effect shall be sent to the assessee.

Provided that except as otherwise provided in this sub-section the acknow-
ledgement of the return shall be deemed to be intimation under this sub-
section where either no sum is payable by the assessee or no refund is due
to him.

An intimation for any tax or interest due under this clause shall not, however,
be sent after the expiry of two years from the end of assessment year in
which the net wealth was first assessable.

(2) In the above cases, if the Assessing Officer considers it necessary or
expedient to ensure that the assessee has not understated the net wealth or
has not underpaid the tax in any manner, he shall serve on the assessee a
notice requiring him, on a date to be specified therein, either to attend at the
office of the Assessing Officer or to produce, or cause to be produced there,
any evidence on which the assessee may rely in support of the return:

Provided that no notice under the sub-section shall be served on the
assessee after the expiry of twelve months from the end of the month in
which the return is furnished.

(3) On the day specified in the notice issued under Sub-section (2) or as soon
afterwards as may be, after hearing such evidence as the assessee may
produce and such other evidence as the Assessing Officer may require on
specified points, and after taking into account all relevant material which he
has gathered, the Assessing Officer shall, by order in writing, assess the net
wealth of the assessee and determine the sum payable by him on the basis
of such assessment.

(4) For the purposes of making an assessment under the Act, the Assessing
Officer may serve, on any person who has made a return under Section 14 or
Section 15 or in whose case the time allowed under Sub-section (1) of
Section 14 for furnishing the return has expired, a notice requiring him on a
date to be specified therein, -

(i) where such person has not made a return within the due date, to furnish
a return of his net wealth or the net wealth of any other person in
respect of which he is assessable under this Act, on the valuation date,
in the prescribed form and verified in the prescribed manner, setting
forth the particulars of such net wealth and such other particulars as
may be prescribed, or

(ii) to produce or cause to be produced such accounts, records or other
documents as the Assessing Officer may require.

(5) If any person, -

(a) fails to make the return required under Sub-section (1) of Section 14 and
has not made a return or a revised return under Section 15, or

(b) fails to comply with all the terms of a notice issued under Sub-
section (2) or Sub-section (4),

the Assessing Officer shall, after taking into account all relevant material
which he has gathered, and after giving such person an opportunity of being
heard, estimate the net wealth to the best of his judgement and determine
the sum payable by the person on the basis of such assessment:

Provided that such opportunity shall be given by the Assessing Officer by
serving a notice calling upon the person to show cause, on a date and time to
specified in the notice, why the assessment should not be completed to the
best of his judgement:

Provided further that it shall not be necessary to give such opportunity in a
case where a notice under Sub-section (4) has been issued prior to the
making of the assessment under the sub-section.

Where a regular or best judgement assessment is made, any tax or interest paid
by the assessee shall be deemed to have been paid towards such regular
assessment and, if no refund is due on regular assessment and the amount refunded
exceeds the amount refundable on regular assessment, the whole of the excess
refunded shall be deemed to be tax payable by the assessee.

Reference to Valuation Officer (Section 16A)

Where for making a Wealth-tax assessment under the Act and Section 7
thereof, read with the relevant rules (in Wealth-tax Rules as well as Schedule III), the
market value of any asset is to be taken into account in such assessment, the
Assessing Officer may refer the valuation of any asset to the Valuation Officer under
the following circumstances.

(i) where the value of the asset has been estimated by a registered valuer and
the Assessing Officer is of the opinion that the value estimated by the
registered valuer is less than its fair market value and it requires an upward
revision;

(ii) in any other case, if the Assessing Officer is of the opinion that fair market
value of the asset exceeds the value of the asset as returned by more than
33-1/3% or by more than ₹ 50,000; or

(iii) if he considers it necessary to do so on account of the nature of the asset and
other relevant circumstances.

On a reference having been made to the valuation officer, he will proceed to
value each asset separately after giving notice to the assessee to produce or cause
to be produced before him, such accounts, records or other documents as he may
require.

Where the Valuation Officer is of the opinion that the value of the asset has been
correctly declared in the return made by the assessee, he shall pass an order in
writing and send a copy of it to the Assessing Officer and to the assessee. Where the
Valuation Officer is of the opinion that the value of the asset is higher than the value
declared by the assessee, or where the asset is not disclosed, or the value of the
asset is not declared in the return, or, where no such return has been made, he shall
serve a notice on the assessee intimating the value which he proposes to estimate
and give him an opportunity to state the objections, if any, on the date specified by
the Valuation Officer. The assessee, either in person or through any other person, or
in writing, can file his objections or produce or cause to be produced such evidence
as he wants to rely on in support of his objections.
After hearing all the evidence which the assessee may produce and considering all the material which the Valuation Officer has gathered, he shall estimate the value of the asset and send a copy of his order to the Assessing Officer and the assessee. The order of the Valuation Officer is binding on the Assessing Officer who, after receiving the order, shall proceed to complete the assessment in conformity with the estimate of the Valuation Officer. Where the Valuation Officer values an asset for an amount less than the amount returned by the assessee, the value assessed by Assessing Officer would be final. Further, the assessee can file an appeal against valuation report and valuation officer is bound to follow valuation rules given under Schedule III.

(3) Wealth Escaping Assessment (Section 17)

If the Assessing Officer has reason to believe that the net wealth chargeable to tax in respect of which any person is assessable under the Wealth-tax Act, has escaped assessment for any assessment year (whether by reason of under assessment or assessment at too low a rate or otherwise), he may, subject to the other provisions of this Section and Section 17A, serve on such person a notice requiring him to furnish within such period, as may be specified in the notice, a return in the prescribed form and verified in the prescribed manner setting forth the net wealth in respect of which such person is assessable as on the valuation date mentioned in the notice, along with such other particulars as may be required by the notice, and may proceed to assess or reassess such net wealth and also any other net wealth chargeable to tax in respect of which such person is assessable, which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section for the assessment year concerned and the provisions of the Wealth-tax Act shall, so far as may be, be applicable as if the return were a return required to be furnished under Section 14.

It is further provided that in cases where assessment under Section 16(3) or this section has been made for the relevant assessment year, no action shall be taken under this section after expiry of four years from the end of the relevant assessment year unless any net wealth chargeable to tax has escaped assessment for such assessment year by reason of failure on the assessee’s part to: (i) make a return under Section 14 or Section 15 or in response to a notice issued under Section 16(4) or this section or, (ii) full and true disclosure of all material facts necessary for his assessment for that assessment year. And, the Assessing Officer shall, before issuing any notice under this sub-section, record his reasons for doing so.

Explanation to the proviso (as above) clarifies that production of account books and other evidence, before the Assessing Officer, from which material evidence could have been discovered by the Assessing Officer with due diligence will not necessarily amount to disclosure.

Sub-section (1A) provides that notice specified at paragraph (1) hereinabove shall not be issued for the relevant assessment year –

(a) if four years have elapsed from the end of the relevant assessment year, unless the case falls under clause (b);
(b) if four years, but not more than six years, have elapsed from the end of the relevant assessment year unless the net wealth chargeable to tax which has escaped assessment amounts to or is likely to amount to rupees ten lakh or more for that year.

(1B)(a) This sub-section restrains issuance of notice by an Assessing Officer below the rank of Assistant Commissioner or Deputy Commissioner unless the Joint Commissioner is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for the issue of such notice in cases where assessment under Section 16(3) or 17(1) has been made for the relevant assessment year.

Additional restraint made by proviso to this sub-section is: after the expiry of four years from the end of the relevant assessment year, notice to be issued only if the Commissioner or Chief Commissioner is satisfied on the reasons recorded by such Assessing Officer about the case being a fit one for the issuance of notice.

(b) In case other than the ones specified at (a) above, no notice shall be issued under Sub-section (1) by an Assessing Officer below the rank of Joint Commissioner, after the expiry of four years from the end of the relevant assessment year, unless the Joint Commissioner is satisfied, on the reasons recorded by such Assessing Officer, that it is a fit case for the issue of such notice.

Sub-Section (2) to Section 17 states that the aforementioned time limit within which any proceeding for assessment or reassessment may be commenced shall not apply to an assessment or reassessment to be made on such person in consequence of or to give effect to any finding or direction contained in an order passed pursuant to: (i) Section 23 [Appeal to the Commissioner (Appeals)]; (ii) Section 24 (Appeal to Appellate Tribunal); (iii) Section 25 (Revisions of orders by Commissioner); (iv) Section 27 (Reference to High Court); (v) Section 29 (Appeal to Supreme Court) or by a Court in any proceeding under any other law.

However, the provisions of Sub-section (2) shall not apply in any case where the assessment or reassessment relates to an assessment year in which an assessment or reassessment could not have been made at the time the order which was the subject matter of the appeal, revision or reference, was made by reason of any provision limiting the time within which any action for assessment or reassessment may be taken.

(4) Time limit for completion of Assessment and Re-assessment

Section 17A, provides as follows:

(1) No order of assessment shall be made under Section 16 at any time after the expiry of two years from the end of the assessment year in which the net wealth was first assessable:

Provided that:

(a) Where the net wealth was first assessable in the assessment year commencing on 1.4.1987 or any earlier assessment year, the assessment can be made on or before 31.3.1991.
(b) Where the net wealth was first assessable in the assessment year
commencing on 1.4.1988, such assessment can be made on or before

Provided further that in case the Assessment Year in which the net wealth
was first assessable is the assessment year commencing on the 1st day of
April, 2004 or any subsequent year, the provisions of this sub-section shall
have effect as if for the words “two years”, the words “twenty-one months”
had been substituted.

(2) No order of assessment or reassessment shall be made under Section 17
after the expiry of one year from the end of the financial year in which the
notice under 17(1) was served:

However, where the notice under Sub-section (1) of Section 17 was served
on or after the 1st day of April, 1999 but before the 1st day of April, 2000,
such assessment or reassessment may be made at any time upto the 31st
day of March, 2002.

Provided further that where the notice under sub-section (1) of Section 17
was served on or after the 1st day of April, 2005, the provisions of this sub-
section shall have effect as if for the words “one year”, the words “nine
months” had been substituted.

Sub-section (3) of Section 17A provides that notwithstanding anything contained
in Sub-section (1) and (2) of Section 17A, an order of fresh assessment in pursuance
of an order passed on or after 1.4.1975 under Section 23A, Section 24 or Section 25
setting aside or cancelling an assessment, may be made at any time before the
expiry of one year from the end of the financial year in which the order under
Section 23A or Section 24 is received by the Chief Commissioner or Commissioner
as the case may be, the order under Section 25 in passed by the Commissioner.

However, where the order under Section 23A or Section 24 is received by the
Chief Commissioner or Commissioner or, as the case may be, the order under
Section 25 is passed by the Commissioner, on or after the 1st day of April, 1999 but
before the 1st day of April, 2000, such an order of fresh assessment may be made at
any time upto the 31st day of March, 2002.

Provided further that where the order under Section 23A or Section 24 is
received by the Chief Commissioner or Commissioner or, as the case may be, the
order under Section 25 is passed by the Commissioner, on or after the 1st day of
April, 2005, the provisions of this sub-section shall have effect as if for the words “one
year”, the words “nine months” had been substituted.

Where the assessment or re-assessment is made on an assessee or any other
person in consequence of, or to give effect to, any finding or direction contained in an
order passed on Appeal Revision or Reference; under Section 23, Section 24,
Section 25, Section 27 or Section 29, or in an order of any court in a proceeding
otherwise than by way of appeal or reference under the Wealth-tax Act, the time
limits prescribed in Sub-sections (1) and (2) Sections 17A will not apply. Such
assessment or re-assessment may be completed at any time subject to the provisio
of Sub-section (3) of that section.
In computing the period of limitation the time taken in the following shall be excluded:

(i) the time taken in re-opening the proceeding or in giving an opportunity to the assessee to be re-heard;

(ii) the period during which the assessment proceeding is stayed by an order or injunction of any Court;

(iii) the period, not exceeding sixty days, commencing from the date on which the Wealth-tax Officer received the declaration under Section 18C (1) and ending with the date on which the order under Sub-section (3) of Section 18C (regarding an identical question of law being pending before the High Court) is made by him or;

(iv) where an application made before the Wealth-tax Settlement Commission is rejected by it, the period commencing from the date on which application is made and ending with the date on which the order is received by the Commissioner from the Commission.

However, where immediately after the exclusion of the aforesaid time or period, the period of limitation referred to in Sub-section (1), (2) and (3) available to the Assessing Officer for making an order of assessment or reassessment as the case may be, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

10.8 LIABILITY TO ASSESSMENT IN SPECIAL CASES

(1) Tax of Deceased Person Payable by Legal Representative (Section 19)

Where a person dies, his executor, administrator or legal representative shall be liable to pay the Wealth-tax assessed or any other sum (interest, fine or penalty) payable by the deceased out of the estate of the deceased person to the extent to which the estate is capable of meeting the charge.

Where a person dies either without furnishing a return or after furnishing incorrect or incomplete return, the Assessing Officer may make an assessment and for this purpose he may serve the required notice to the legal representative to produce any accounts, documents or evidence which might have been required from the deceased person if he had survived.

The legal representative shall also be liable to file a return (if the deceased had not filed it) or a belated return or revised return or pay tax on wealth escaping assessment. However, his liability is restricted to the assessment years in which the assessee has expired or earlier assessment year for which the assessment has not been made. He shall not be liable for the tax for valuation date falling after his death.

If the penalties are imposed prior to death, the same may also be collected from the legal representative but, for the default made by the deceased, no penalty can be levied on the legal representative [Smt. Yawarunnissa Begum v. WTO (1975) 100 ITR 645 (A.P.).]

Similarly, the penalty proceedings commenced against the deceased cannot be
continued after his death against his legal representative [Remeshwar Prasad v. CWT (1980) 124 ITR p. 77].

Following the Allahabad High Court’s decision in the case of Rameshwar Prasad v. Commissioner of Wealth-tax (1980, 124 ITR 77) the Madhya Pradesh High Court held in the case of Commissioner of Wealth-tax v. Abdul Mazid Khan (1984, 147 ITR 53) that Section 19(1) does not provide for the continuation of penalty proceedings against the legal representative when the assessee dies before the proceedings are concluded. In the absence of any provision like Section 159 of the Income-tax Act, 1961 in the Wealth-tax Act, it could not be held that penalty proceedings started against an assessee under Section 18 could be continued against his legal representatives.

The Andhra Pradesh High Court’s decision in the case of Smt. Yawarunnissa Begum v. Wealth-tax Officer (supra) was followed by the Allahabad High Court in the case of Ram Prasad (supra) and by the Madhya Pradesh High Court in the case of Abdul Mazid Khan (supra).

(2) Assessment in the case of Executors (Section 19A)

After the death of a person, his estate is chargeable to Wealth-tax in the hands of the executor/s who are treated as an individual and whose residence and citizenship shall be the same as those of deceased on the valuation date immediately preceding his death.

The assessment of an executor under this section shall be made separately from any assessment that may be made on him in respect of his own net wealth or on the net wealth of the deceased under Section 19.

Separate assessment shall be made on the executor in respect of the net wealth as on each valuation date from the date of the death of the deceased to the date of complete distribution to the beneficiaries of the estate according to their interests. If he has distributed any assets of the estate, the value thereof shall not be included in the net wealth of deceased but it shall be included in the net wealth of beneficiary, if he continues to own the asset on the valuation date.

(3) Assessment after Partition of a Hindu Undivided Family (Section 20)

Where, at the time of making an assessment, it is brought to the notice of the Assessing Officer that a partition has taken place, on the valuation date, amongst the members of a H.U.F. and the Assessing Officer, after enquiry, is satisfied that the joint property has been partitioned as a whole among the various members in definite portions, he shall record an order to that effect and shall make assessments on the H.U.F. for that assessment year as well as for any earlier year/s. Every member of the family shall be liable jointly and severally for the tax assessed on the net wealth of the family.

Where the partition has taken place during the previous year prior to the valuation date, the family as such shall not be liable for the tax after the partition but each member shall be liable to pay tax on his net-wealth.

Where the Assessing Officer is not satisfied about the partition of the family, he
may declare that the family shall be deemed to continue to be a H.U.F. However, if a member gets out of it after taking his share of the joint property, the reduced family shall be liable to be taxed as a unit in respect of the diminished net wealth.

(4) Assessment after Partial Partition of a Hindu Undivided Family (Section 20A)

Where a partial partition has taken place after the 31st day of December, 1978, among the members of a Hindu undivided family hitherto assessed as undivided, such family shall continue to be liable to be assessed under this Act as if no such partial partition had taken place, and each member or group of members of such family shall be jointly and severally liable for any tax, penalty, interest, fine or other sum payable under this Act by the family in respect of any period, whether before or after such partial partition. Partial partition is no partition after the above date. However, the several liability of any member or group of members aforesaid shall be computed according to the portion of the joint family property allotted to him or it at such partial partition.

‘Partial partition’ means a partition which is partial as regards the persons constituting the family or the properties belonging to the family, or both.

(5) Assessment of Charitable Trusts (Section 21A)

Where any property is held under trust for any public purpose of a charitable or religious nature in India and (i) any part of such property or any income of the trust is used or applied; or (ii) any part of the income of the trust, being a trust created on or after 1.4.1962, enures directly or indirectly for the benefit of (a) the author of the trust or the founder of the institution; or (b) a person who has made substantial contribution to the trust; or (c) where the author or founder is a H.U.F., a member of the family; or (d) any trustee of the trust or manager of the institution; (e) any relative of the author, founder person, member, trustee or manager or member of H.U.F.; or (f) concern in which any of the person referred to clauses (a), (b), (c), (d) and (e) has substantial interest, for any period during the previous year, such a trust institution shall be liable to pay wealth-tax on the value of the entire property. Wealth-tax for the purposes of this section shall be leviable upon, and recoverable from the trustee or manager (by whatever name called) in the like manner and to the same extent as if the property were held by an individual who is a citizen of India and resident in India for the purposes of this Act.

Wealth-tax for the purposes of this section shall be leviable upon, and recoverable from the trustee or manager (by whatever name called) in the like manner and to the same extent as if the property were held by an individual who is a citizen of India and resident in India for the purposes of this Act.

(6) Assessment of an Association of Persons (Section 21AA)

Where there is an “association of persons” other than a company or a co-operative society “or society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India” in which the shares of individual members are indeterminate on the date of its formation or any time thereafter, Wealth-tax will be levied upon and recovered from such
association in the same manner and to the same extent as is leviable upon an individual resident citizen for the purposes of the Act.

Where any business or profession carried on by such association has been discontinued or the association is dissolved, the Assessing Officer shall make an assessment of the net wealth of such association as if no discontinuance or dissolution had taken place.

Every person who was, at the time of such discontinuance or dissolution, a member of the association of persons, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

(7) Assessment of Persons Residing outside India (Section 22)

Where the person liable to wealth-tax resides outside India, the tax may be levied upon and collected from his agent and his agent shall be deemed to be the assessee in respect of such tax. Any of the following persons may be appointed by the Assessing Officer as the agent of the person residing outside India after giving him a notice and an opportunity of being heard:

(i) an employee of the person resident outside India;
(ii) a person through whom he received any income, profit or gain;
(iii) a person who is in possession or custody of any asset of a non-resident and upon whom the Assessing Officer has caused a notice to be served of his intention of treating him as the agent of such person.

The agent is entitled to recover the amount so paid from the person on whose behalf it is paid or to retain out of any money that may be in his possession or may come to him in the capacity of an agent.

Any agent or any person, who apprehends that he may be assessed as an agent of an outsider, he may retain out of any money payable by him to the principal, a sum equal to the estimated Wealth-tax liability. In the case of disagreement regarding the amount to be so retained, the agent may secure a certificate from the Assessing Officer stating the amount to be so retained. If the agent fails to retain the amount, he runs the risk of having to pay the wealth-tax out of his own pocket.

In the final settlement, the amount recoverable from the agent cannot exceed the amount specified in the certificate. However, the Assessing Officer can realise the excess out of any additional assets of the principal in the hands of the agent or recover it from any assets of the outsider that may at any time come within India.

---

**Test Your Knowledge**

The Hindu undivided family is the owner of the properties in an impartible estate.

- True
- False

**Correct answer: True**
10.9 PAYMENT AND RECOVERY OF WEALTH-TAX

(1) Notice of Demand (Section 30)

After an order has been made under this Act imposing any tax, interest, penalty, fine or any other sum, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable. According to Rule 4 of the Wealth-tax Rules the notice of demand shall be in Form C.

Any failure on the part of the Assessing Officer to comply with the requirements of Rule 4 in regard to the particulars therein specified, or any failure on the part of the Wealth-tax Officer to serve the notice is required by this section will invalidate the subsequent proceeding in recovery.

Whether fresh Notice of Demand is necessary after an order on appeal or other proceedings?

The answer is: No such notice is necessary. But if the result of the appellate or other proceedings is to reduce the original assessment, another notice is necessary.

Payment (Section 31)

The amount demanded shall be paid within 30 days of the service of the notice at the place and to the person mentioned in the notice. However, if the Assessing Officer has reason to believe that if the period of full 30 days is allowed to the assessee, it will be detrimental to the Revenue, he may, with the previous approval of the Joint Commissioner, reduce period for the payment of the sum demanded.

Section 29A also provides that the Wealth-tax, as assessed, is payable though a reference has been made to the High Court or the Supreme Court. The provision implies that mere pendency of reference will not amount to a stay for recovery of demand.

If the demanded amount is not paid within 30 days or such lesser period, as may be prescribed by the Assessing Officer, the assessee shall be liable to pay simple interest @1% for every month or part of month for the period of default, i.e., the next day of the last date for payment, to the actual date of payment. According to Rule 12 the period and the amount in respect of which the interest is to be calculated shall be rounded off.

The rules regarding rounding off are as under:

(i) where interest is to be calculated on annual basis, the period for which such interest is to be calculated shall be rounded off to a whole month or months and for this purpose any fraction of a month shall be ignored; and the period so rounded off shall be deemed to be the period in respect of which the interest is to be calculated;

(ii) where the interest is to be calculated for every month or part of a month comprised in a period, any fraction of a month shall be deemed to be a full month and the interest shall be so calculated;

(iii) the amount in respect of which the interest is to be calculated shall be
rounded off to the nearest multiple of one hundred rupees and for this purpose any fraction of one hundred rupees shall be ignored; and the amount so rounded off shall be deemed to be the amount in respect of which the interest is to be calculated.

Where, as a result of an order under appeal the amount on which interest was payable had been reduced, the interest shall be reduced accordingly and the excess interest paid, if any, shall be refunded. And, in respect of any period commencing on or after 7.9.2003, the interest for the period falling after that date shall be calculated @1% for every month or part of the month.

On an application made by the assessee before the expiry of the due date for payment, the Assessing Officer may extend the time for payment or allow the payment by instalments subject to such conditions as he may think fit to impose. If the assessee fails to pay the amount within the time allowed, he shall be deemed to be in default. Further in case of payment by instalments where the assessee commits any default in paying any one of the instalments within the time fixed, the assessee shall be deemed to be in default as to the whole amount due on that date and the other instalment or instalments shall be deemed to have been due on the same date as the instalment actually in default.

Where an assessee has presented an appeal to the commissioner (Appeals), the Assessing Officer may treat the assessee as not being in default in respect of the amount in dispute in the appeal so long as the appeal remains undisposed of. The assessee shall not be deemed to be in default where he has been assessed in respect of assets located in a country outside India, the laws of which prohibit or restrict the remittance of money to India. He shall not be deemed to be in default in respect of that part of the tax only which is attributable to the assets in that country and until the prohibition or restriction of remittance is removed. But, as soon as restriction on remittance is removed, the assessee must make the payment within the specified time, failing which he would be treated as assessee in default.

Mode of Recovery (Section 32)

The provisions relating to the mode of recovery of Income tax apply also to the recovery of Wealth-tax.

(2) Liability of Transferees of Properties (Section 33)

If an individual transfers assets to any of the persons mentioned in Section 4 (i.e., to spouse to a person or association of persons for the benefit of his or her spouse etc.) the transferred assets are included in the net wealth of transferor and he would be assessed to tax in respect thereof. Normally, as a general rule a transferee of property is not liable to pay tax due by the transferor in respect of a transferred asset but Section 33 provides that after issuing a notice of demand, the portion of the tax attributable to the transferred asset (on a pro rata basis) may be recovered from the transferee. If the transferred asset is held jointly by more than one persons, they shall be jointly and severally liable to pay the tax. If the transferee fails to pay the tax demanded from him, he shall be deemed in default and all the provisions relating to recovery shall apply accordingly.
10.10 REFUNDS (SECTION 34A)

Where a refund of any amount becomes due to the assessee, as a result of an appeal or other proceedings (reference, rectification of mistake or revision) the Assessing Officer shall refund the amount to the assessee without his having to make any claim in that behalf. However, where, by the order aforesaid, an assessment is set aside or cancelled and an order of fresh assessment is directed to be made, the refund, if any shall become due only on the making of such fresh assessment. And, if the assessment is annulled, the refund shall become due only of the amount, if any, of the tax paid in excess of the tax chargeable on the net wealth returned by the assessee.

Further, where refund of any amount becomes due to the assessee as a result of an order of assessment, whether pursuant to the filing of a return of wealth within or after due date/amendment or in response to a notice etc. and the Assessing Officer is of the opinion that in view of the matter being the subject-matter of an appeal or further proceeding or any other proceeding being pending, the grant of refund is likely to adversely affect the revenue, he may, with the previous approval of the Chief Commissioner or Commissioner, withhold the refund till such time as determined by the Chief Commissioner or Commissioner.

Where a refund is found due to any person, the Assessing Officer, the Deputy Commissioner (Appeals), or Commissioner (Appeals) or Chief Commissioner, or Commissioner after giving a written intimation to the assessee, may, in lieu of payment, set off the amount of refund against the amount, if any, remaining payable under this Act by the assessee.

With effect from 7.9.2003, as per Sub-section (4B), where any refund becomes due to the assessee under the Wealth-tax Act, he is entitled to receive simple interest thereon @ 1/2 per cent for every month or part of a month from the date/s of payment of the tax or penalty to the date of grant of refund. In the case of delay in the proceedings, attributable to the assessee, the period of delay shall be excluded from the period for which he is entitled to the interest. Further, in the case of reduction or increase in the amount on which interest is payable, as a result of an order of assessment or the orders by Appellate authorities in appeal, revision, or order of the Wealth-tax Settlement Commission, the interest shall also be correspondingly increased or reduced. In the case where the interest is reduced, the Assessing Officer shall issue a notice of demand to the assessee, calling for payment of the excess interest paid.

10.11 RECTIFICATION OF MISTAKES (SECTION 35)

With a view to rectify any mistake apparent from the record, the Assessing Officer, a Wealth-tax authority, the Valuation Officer, the Joint Director, Joint Commissioner, Director, Commissioner, Commissioner (Appeals), Appellate Tribunal may amend their respective orders either on his/its own motion or when it is brought to notice either by the assessee or where the authority concerned is the Valuation Officer or the Commissioner (Appeals) or the Appellate Tribunal, by the Assessing Officer.
If the amendment enhances the assessment or reduces a refund, the authority concerned cannot do so without giving a notice to the assessee of its intention to do so and allowing him a reasonable opportunity of being heard.

If the assessee pays any amount of tax, penalty or interest in dispute within 6 months from the date of order passed in the first appeal or revision, the sum so paid would be allowed as a permissible deduction. This deduction would be allowed as a deemed rectification of mistake.

The order of amendment shall be passed in writing by the authority concerned and where it has the effect of enhancing the assessment or reducing a refund already made, the Assessing Officer shall serve on the assessee a notice of demand specifying the sum payable.

The time limit for rectification is four years from the end of the financial year in which the order was passed in the first appeal or revision and in other cases it is four years from the end of the financial year in which the order sought to be amended was passed.

10.12 SETTLEMENT OF CASES

The provisions regarding settlement of cases under this Act are the same as those of the Income-tax Act. Therefore, the students are advised to study these provisions from the study material supplied for the Income-tax Act.

10.13 APPEALS, REVISIONS AND REFERENCES

(1) Appeal to the Commissioner (Appeals) [Section 23(1)]

Where any person is not satisfied by any of the following orders of the Assessing Officer he may file an appeal to the Commissioner (Appeals):

(i) objecting to the amount of net wealth determined; or
(ii) objecting to the amount of net wealth-tax determined; or
(iii) denying his liability to be assessed under this Act; or
(iv) objecting to any penalty imposed by Assessing officer under Section 18; or
(v) objecting to any order under Section 20(2) (refusing to accept the partition of H.U.F.); or
(vi) objecting to any penalty imposed on account of default in making a payment of tax; or
(vii) objecting to any order treating him as the agent of a person residing outside India; or
(viii) objecting to any order under rectification of mistakes having the effect of enhancing the assessment or reducing a refund or refusing to allow the claim made by the assessee; or
(ix) objecting to any order of the Valuation Officer having the effect of enhancing the valuation of any asset or refusing to allow the claim made by the assessee.
(2) Appeal to Commissioner (Appeals) [Section 23(1A) & (B)]

Any person who is not satisfied by any of the following orders may file an appeal to the Commissioner (Appeals), in the prescribed form and verified in the prescribed manner:

1. objecting to the amount of the Net wealth/amount of Wealth-tax determined to be payable or denying his liability to be assessed under this Act. The above is subject to the condition that the total wealth determined in assessment made under Section 16 exceeds ₹ 15 lakhs;

2. objecting to the penalty imposed under Section 18(1), with the previous approval of the Deputy Commissioner, under Section 18(3); or

3. objecting to any assessment or order referred to in the preceding items (i) to (vii), where such assessment or order has been made by the Deputy Commissioner in exercise of the powers or functions conferred on or assigned to him under Section 8 or 11; or

4. objecting to any penalty imposed by the Joint Director or Joint Commissioner under Section 18A; or

5. objecting to an order made by an Assessing Officer in case of such persons or classes of persons as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations, direct.

Sub-Section (1B), further provides that notwithstanding anything contained in Sub-section (1), the Board or the Director General or the Chief Commissioner or Commissioner, if so authorised by the Board may, by order in writing, transfer any appeal which is pending before a Deputy Commissioner (Appeals) and any matter arising out of or connected with such appeal and which is so pending, to the Commissioner (Appeals) if the Board or, as the case may be, the Director General, the Chief Commissioner or Commissioner (at the request of the appellant or otherwise) is satisfied that it is necessary or expedient so to do having regard to the nature of the case, the complexities involved and other relevant considerations and the Commissioner (Appeals) may proceed with such appeal or matter from the stage at which it was before it was so transferred:

Provided that the appellant may demand that before proceeding further with the appeal or matter, the previous proceeding or any part thereof be re-opened or that he be re-heard.

Appealable orders before Commissioner (Appeals) [Section 23A]

1. Any person may appeal to the Commissioner (Appeals) against the assessment or order:

   a. objecting to the amount of net wealth determined under this Act.

   b. objecting to the amount of Wealth Tax determined as payable by him under this Act.

   c. denying his liability to be assessed under this Act.

   d. objecting to any penalty imposed by the assessing officer under Section 18 or Section 18A.

   e. objecting to any order of the assessing officer under Sub-section (2) of
Section 20.

(f) objecting to any penalty imposed by the assessing officer under the provision of Section 221 of the Income-tax Act as applied under Section 32 for the purposes of Wealth Tax.

(g) objecting to any order made by the assessing officer under Section 22 treating him as agent of a person residing outside India.

(h) objecting to any order of the assessing officer under Section 35 having the effect of enhancing the assessment or reducing a refund or refusing to allow the claim made by the assessee under the said section, or

(i) objecting to any order of the Valuation Officer under Section 35 having the effect of enhancing the valuation of any asset or refusing to allow the claim made by the assessee under the said section, or

(j) objecting to any penalty imposed by the Deputy Director or Deputy Commissioner under Section 18A.

The application in duplicate, has to be in the prescribed form (form E) and verified in the prescribed manner and on payment of a fee of two hundred and fifty rupees.

Explanation: For the purpose of this sub-section where on or before 1st day of October, 1998, the post of Deputy Commissioner has been redesignated as Joint Commissioner and the post of Deputy Director has been redesignated as Joint Director the reference in this sub-section for “Deputy Commissioner” and “Deputy Director” shall be substituted by “Joint Commissioner” and ‘Joint Director” respectively.

(2) Every appeal pending before the Deputy Commissioner (Appeals), immediately before the appointed day and any matter arising out of or connected with such appeal shall stand transferred to the Commissioner (Appeals) and he may proceed with such appeals or matter from the stage on which it was on that day. However, the appellant may demand that before proceeding further with the appeal or matter, the previous proceedings or any part thereof be reopened or that he be reheard. Appointed day means the day appointed under Section 246A of the Income-tax Act.

(3) An appeal shall be presented when thirty days of the receipt of the notice of demand relating to the assessment or penalty objected to or the day on which any order objected to is communicated to him. The Commissioner (Appeals) may, however, admit an appeal after the expiry of the aforesaid period, if he is satisfied that the appellant had sufficient cause for not presenting the appeal within that period.

Section 23A further provides that appeal is admitted only if the assessee has paid the tax due on the net wealth returned by him.

In every appeal, the Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed under Section 23A(1).

The order of Commissioner (Appeals) shall be in writing and shall state the points
for determining the decision thereof and reasons for the decision and a copy of every order so passed shall be forwarded to the appellant and the Chief Commissioner or Commissioner.

Order passed by the Appellate Tribunal on appeal shall be final except as provided in Section 27 or Section 27A.

(3) Appeal to the Appellate Tribunal (Section 24)

Where the assessee is not satisfied by any of the following orders of the Commissioner (Appeals), he may file an appeal to the Appellate Tribunal within sixty days of the date on which the order is communicated to him:

1. penalty under Section 18; or
2. penalty under Section 18A; or
3. order passed by the Commissioner (Appeals) under Section 23 or Section 23A; or
4. imposing a fine under Section 37(2).

In the same way, if the Commissioner is not satisfied by the order of the Commissioner (Appeals), he may direct the Assessing Officer to appeal to the Appellate Tribunal against the order. The appeal shall be filed in the prescribed Form F and within 60 days of the date of which the order sought to be appealed against is communicated to the Commissioner. If the appeal is filed by the assessee, it shall accompany a fee of ₹ 1000. However, for appeal not relatable to net wealth as computed by the Assessing Officer, fee is ₹ five hundred.

After receiving the application from the aggrieved party in form F, the Appellate Tribunal shall issue a notice to the other party that an appeal against the order has been preferred. The other party may file a memorandum of cross objections in the prescribed Form G against the order within 30 days of the receipt of the notice. The memorandum of cross objections shall be treated as if it were an appeal presented by the other party. If the assessee or the Assessing Officer, as the case may be, fails to file the appeal or memorandum of cross objection in the prescribed time, the Appellate Tribunal may admit it after the expiry of relevant period if it is satisfied that there was sufficient cause for not presenting it within the prescribed time.

The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such order as it deems fit. However, it is not empowered to enhance the assessment or penalty without giving an opportunity to the assessee showing cause against such assessment.

By amendment in this section Finance Act, 1999 has provided that in every appeal the Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed. It is further provided that the cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal.

A copy of the order passed by the Tribunal shall be forwarded to the assessee and the Commissioner. The decision of the Tribunal regarding the facts of the case shall be final.
(4) **Revisions of Orders by Commissioner (Section 25)**

The Commissioner can revise the orders passed by any authority subordinate to him under two circumstances:

1. In the interest of the assessee.
2. In the interest of the revenue.

The Commissioner, either on his own motion or on an application by the assessee for revision, can call for the record of any proceeding under this Act which has been conducted by any authority subordinate to him (including the Appellate Assistant Commissioner). After making such enquiry as may be necessary, the Commissioner may pass such orders as he thinks fit. However, the order cannot be prejudicial to the assessee. The Commissioner is not empowered to revise any order on his own motion if a period of more than one year has expired from the date of the order sought to be revised. If the application is made by the assessee for revision, it must be accompanied by a fee of ₹ 25 and it must be made within one year from the date of the order sought to be revised or within such further period as the Commissioner may think fit, allowing that the assessee was prevented by sufficient cause from making the application within the prescribed time. If the Commissioner refuses to interfere, it shall not be deemed an order prejudicial to the assessee. Further, the Commissioner shall not revise any order in the following cases:

1. where an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal, the time within which such appeal can be made has not expired or in the case of an appeal to the Tribunal, the assessee has not waived his right of appeal.
2. where the order is the subject of an appeal before the Commissioner (Appeals) or the Tribunal.

The Commissioner on his own motion, may call for and examine the record of any proceeding under this Act and if he considers that any order passed by the Assessing Officer is prejudicial to the interests of the revenue, he may, after giving the assessee a reasonable opportunity of being heard and after making or causing to be made the necessary enquiries pass such order as the circumstances of the case justify. At the time of revision, he can enhance or modify the assessment or cancel it and direct for a fresh assessment. However, no order shall be made after the expiry of 2 years from the date of the order sought to be revised. In respect of any application made on or after 1st October, 1998, it shall be obligatory on the Commissioner to pass an order within a period of one year from the end of financial year in which such application is made by the assessee for revision. But, an order in revision can be passed by the Commissioner at any time, in the case of any order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Tribunal, the High Court or the Supreme Court. Further in computing the period of two years, the time taken in giving an opportunity to the assessee to be re-heard (under Section 39) and any period during which proceeding under this section is stayed by an order of injunction of any court shall be excluded.

(5) **Reference to the High Court (Sections 27)**

Section 27 provides for a reference on a question of law to the High Court. The
assessee or the Commissioner may, within 60 days of the date on which he is served with an order of the Appellate Tribunal or the Commissioner [under Section 24 or 25 by application in the prescribed form ‘H’ require the Appellate Tribunal to refer to the High Court any question of law arising out of such order. A question will be said to arise out of the Tribunal’s order only if it has been raised before or decide by the Tribunal.

However, no application shall be made to the Appellate Tribunal to make a reference to the High Court on or after 1st day of June 1999 as provided by Finance Act, 1999.

The Tribunal may accept an application within 30 days even after the expiry of the prescribed time (60 days) if it satisfied that the applicant was prevented by sufficient cause from presenting the application within time.

If the application is made by the assessee for reference of the case to the High Court, it must be accompanied by a fee of ₹ 200.

On receipt of an application for reference, the Tribunal shall state the case to the High Court within 120 days of the receipt of the application. Where the Tribunal refuses to state the case either on the ground that no question of law arises from its order, or that the application is time barred, the aggrieved party may apply to the High Court against the refusal by the Tribunal to state the case to it. In this case the application must be presented within 90 days from the date on which he is served with a notice of refusal or rejection. The High Court may admit an appeal even after the expiry of the period of one hundred and twenty days if it is satisfied that there was sufficient cause for not filing the same within that period.

If the court is not satisfied with the decision of the Tribunal, it may require the Tribunal to state the case and on receipt of such requisition the Tribunal shall state the case.

Where the assessee is satisfied on the Tribunal’s refusal to state the case on the ground that no question of law arises, he may, within 30 days from the date on which he receives notice of refusal, withdraw his application and if he does so, the fees paid by him shall be refunded to him.

Where the Tribunal is of the opinion that on account of conflict of decisions between the different High Courts in respect of any particular question of law, it is expedient to refer the question to the Supreme Court, it may refer the question to the Supreme Court through its President.

The Tribunal shall state the facts of the case, its own finding and the questions of law which are required for reference. If the Court finds that the statement does not set out all the points which might have been referred, it may send the case back for making such necessary modifications as may be directed by the Court.

The court, upon hearing the reference, shall decide the question of law raised therein and deliver the judgement containing the grounds on which decision is founded. A copy of the judgement shall be sent under seal of the court and the signature of the Registrar to the Tribunal. The Tribunal shall pass such orders as are necessary for disposing of the case conformably to such judgement.
The costs of the reference to the court excluding the fee for making the reference shall be in the discretion of the court.

(6) Appeal to High Court (Section 27A)

Section 27A has been inserted by Finance (No. 2) Act, 1998 to provide that an appeal shall lie to the High Court from every order passed on an appeal by Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law. An appeal can be made within 120 days of the date of service of relevant order.

The High Court may admit an appeal even after the expiry of the period of one hundred and twenty days if it is satisfied that there was sufficient cause for not filing the same within that period.

In an appeal under the new section, the Memorandum of Appeal shall precisely state the substantial question of law involved in the appeal.

Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate the question. The appeal shall be heard only on the question so formulated and the respondent shall, at a hearing of the appeal, be allowed to argue such question. However, nothing in this section shall be deemed to take away or abridge the power of the court to hear for reasons to be recorded, appeal in any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

The High Court decides the formulated question of law and deliver judgement containing the grounds on which such decision is founded. It may also award costs.

The assessing officer is required to give effect to the order of the High Court on the basis of a certified copy of the judgement delivered. In the case of appeal to High Court the provisions of the Code of Civil Procedure, 1908 apply.

Section 28 - Hearing by High Court

The case referred to or appeal filed to in the High Court shall be heard by a Bench of not less than two judges, the case is to be decided unanimously or where they differ, according to the opinion of the majority. Where the number of judges hearing the case is even and there is no majority in forming an opinion on a point the case shall be heard on that point only by one or more other judges of the Court. Such point shall then be decided according to the opinion of the majority of the judges who have heard the case, including those who first heard it.

(7) Appeal to Supreme Court (Section 29)

An appeal may lie to the Supreme Court from any judgement of a High Court provided the High Court certifies the case to be a fit one for appeal to the Supreme Court. The High Court grants such certificate only if a substantial question of law is involved in the case or the question is likely to occur in future or if the question is otherwise of great public or private importance, if, however, the High Court decide not to give such a certificate, then the aggrieved party, may make an application to the Supreme Court under Article 136 of the Constitution of India.

The Supreme Court, after hearing the appeal, may either affirm, vary or reverse the decision of the High Court. Accordingly, the decision of the supreme Court shall be sent to the Tribunal which shall pass such orders as are necessary for disposing of the case in conformity with such judgement.
10.14 PENALTIES UNDER THE WEALTH-TAX ACT

The non-compliance with the various provisions of Wealth-tax Act, Sections 15B(3), 18, 18A and 32 provide for the levy of penalty on the assessee. In addition, Sections 35A to 35L contain provisions under which an assessee might be prosecuted for certain offences under the Wealth-tax Act. The various terms of penalty are described below:

(1) Penalties Imposable under Wealth-tax Act

The various items of penalties imposable and prosecutions under the Wealth-tax Act, are as under:

<table>
<thead>
<tr>
<th>Section</th>
<th>Nature of default</th>
<th>Penalty/Fine</th>
</tr>
</thead>
<tbody>
<tr>
<td>15B(3)</td>
<td>Failure to pay tax or interest payable on self-assessment</td>
<td>Liable for penalty by deeming assessee to be in default (Not exceeding 100% of tax in arrears)</td>
</tr>
<tr>
<td>18(1)(ii)</td>
<td>Failure to comply with notice under section 16(2) or (4) without reasonable cause</td>
<td>Minimum: ₹ 1,000 for each failure Maximum: ₹ 25,000 for each failure</td>
</tr>
<tr>
<td>18(1)(iii)</td>
<td>Concealment of wealth</td>
<td>Minimum: 100% of tax sought to be avoided Maximum: 500% of tax sought to be avoided</td>
</tr>
<tr>
<td>18A(1)(a), (b) and (c)</td>
<td>Failure to answer questions (i) legally bound or (ii) sign statements legally required or (iii) comply with summons under section 37(1) without reasonable cause.</td>
<td>Minimum: ₹ 500 for each failure/default Maximum: ₹ 10,000 for each failure/default</td>
</tr>
<tr>
<td>18A(2)</td>
<td>Failure to furnish in due time statement/information required under section 38 without reasonable cause.</td>
<td>Minimum: ₹ 100 for every day of default Maximum: ₹ 200 for every day of default</td>
</tr>
<tr>
<td>32</td>
<td>Committing default in payment of tax</td>
<td>Not exceeding 100 per cent of tax in arrears</td>
</tr>
<tr>
<td>(A)</td>
<td>(B)</td>
<td>(C)</td>
</tr>
<tr>
<td>-----</td>
<td>-----</td>
<td>-----</td>
</tr>
<tr>
<td><strong>PROSECUTIONS</strong></td>
<td>Wilful attempt to evade tax, penalty or interest: in case amount sought to be evaded exceeds ₹ 1,00,000</td>
<td>6 months’ rigorous imprisonment which may extend to 7 years and fine without prejudice to penalty imposable under any other provision of the Act.</td>
</tr>
<tr>
<td></td>
<td>in any other case</td>
<td>3 months’ rigorous imprisonment which may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act.</td>
</tr>
<tr>
<td><strong>35A(2)</strong></td>
<td>Wilful attempt to evade payment of tax, penalty or interest</td>
<td>3 months’ rigorous imprisonment which may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act.</td>
</tr>
<tr>
<td><strong>35B</strong></td>
<td>Wilful failure to furnish in due time return of wealth in terms of section 14(1) or 14(2) or 17(1)-</td>
<td>Up to 1 year rigorous imprisonment or fine between ₹ 4 and ₹ 10 for every day of default or with both</td>
</tr>
<tr>
<td>(a) in case where tax sought to be evaded exceeds ₹ 1,00,000</td>
<td>6 months’ rigorous imprisonment which may extend to 7 years and fine</td>
<td></td>
</tr>
<tr>
<td>(b) in any other case</td>
<td>3 months’ rigorous imprisonment which may extend to 3 years and fine</td>
<td></td>
</tr>
<tr>
<td><strong>35C</strong></td>
<td>Wilful failure to produce accounts/records in terms of section 16(4)</td>
<td>Up to 1 year rigorous imprisonment or fine between ₹ 4 and ₹ 10 for every day of default or with both</td>
</tr>
<tr>
<td><strong>35D</strong></td>
<td>Filing of false statement in verification (other than under Section 35AB)</td>
<td></td>
</tr>
<tr>
<td>(A)</td>
<td>(B)</td>
<td>(C)</td>
</tr>
<tr>
<td>-----</td>
<td>-----</td>
<td>-----</td>
</tr>
<tr>
<td>regarding registration of valuers/delivering false statement-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) in case where tax sought to be evaded exceeds ₹ 1,00,000</td>
<td>6 months’ rigorous imprisonment which may extend to 7 years and fine</td>
<td></td>
</tr>
<tr>
<td>(b) in any other case</td>
<td>3 months’ rigorous imprisonment which may extend to 3 years and fine</td>
<td></td>
</tr>
<tr>
<td>35E</td>
<td>Making false statement in verification mentioned in section 35AB</td>
<td>Imprisonment up to 6 months or fine or both</td>
</tr>
<tr>
<td>35EE</td>
<td>Failure without reasonable cause, to furnish particulars under section 35ACC regarding intimation by registered valuer of his conviction of any offence</td>
<td>Rigorous imprisonment up to 2 years and fine</td>
</tr>
<tr>
<td>35EEE</td>
<td>Making contravention of order made under section 37A/(3A)</td>
<td>Up to 2 years rigorous imprisonment and fine.</td>
</tr>
<tr>
<td>35F</td>
<td>Abetting or inducing another person to make and deliver false accounts, statement or declaration relating to net wealth chargeable to tax:</td>
<td></td>
</tr>
<tr>
<td>(a) in case where tax, etc. sought to be evaded exceeds ₹ 1,00,000</td>
<td>6 months’ rigorous imprisonment which may extend to 7 years and fine</td>
<td></td>
</tr>
<tr>
<td>(b) in any other case</td>
<td>3 months’ rigorous imprisonment which may extend to 3 years and fine</td>
<td></td>
</tr>
<tr>
<td>35G</td>
<td>Second and subsequent offences under sections 35A(1), 35B, 35D or 35F</td>
<td>6 months’ rigorous imprisonment which may extend to 7 years and with fine</td>
</tr>
</tbody>
</table>

*Note: Prosecution has to be initiated with the previous sanction of specified wealth-tax authorities who have also power to compound offences vide section 35.1*
The student should also note that by virtue of the provisions of Sections 34A and 37C, as amended: (a) interest @ \( \frac{1}{2} \% \) for every month or part of the month on the refund due on the assessee is payable to him by the Wealth-tax authorities for the period specified in Section 34A, and (b) interest @ 15% per annum is payable by the Central Government on the surplus remaining after the application of the assessee’s assets by the assessing authorities towards recovery of the Wealth-tax due from him (for the period specified in Section 37C).

Failure to furnish return on time is not a continuing default. The quantum of penalty will be determined in accordance with the provisions as they stood on the date on which the return was due. [C.W.T. v. Mor Shrikant Ramnaryan. (1984) 147 I.T.R. 412].

Section 18 provides for penalty for failure to furnish returns to comply with notice and concealment of assets etc. If the Assessing Officer, Commissioner (Appeals), Chief Commissioner or Commissioner or Appellate Tribunal, in the course of any proceeding under the Wealth-tax Act is satisfied that any person has failed to: (i) comply with the notice under Sub-sections (2) or (4) of Section 16, or (ii) has concealed the particulars of any assets or furnished inadequate particulars of any assets or debts, he or it may, by an order in writing, direct that such person shall pay, in the case of (i) hereinabove, in addition to the amount of Wealth-tax payable by him, the penalty which may be minimum of \( \text{Rs} 1,000 \) and maximum \( \text{Rs} 25,000 \). The penalty payable in the case of (ii) hereinabove is minimum the amount of tax sought to be evaded by reason of concealment of the particulars of any assets or furnishing of inadequate particulars in respect of any assets or funds. The maximum penalty imposable in this case is five times the amount of tax sought to be evaded. In the case of non-compliance with the notice under Section 16(2) or (4), the penalty is not imposable if the person proves that there was reasonable cause for the failure referred to thereunder.

Explanation 3 to Sub-section (1) provides that where any person, who is not previously assessed under the Wealth-tax Act fails, without reasonable cause, to furnish within the time limit for completion of assessment (Section 17A), the return of his net wealth in respect of assessment year 1989-90 onwards and till the expiry of the time limit relevant thereto (two years) no notice has been issued to him by the assessing authority and the concerned assessing authority is satisfied that in respect of such assessment year, such person is assessable for Wealth-tax, he shall be deemed to have concealed the particulars of his assets or furnished inadequate particulars of any asset or debt in respect of such assessment year, even if such person has furnished the return of his net wealth at any time after the expiry of the applicable periods under Section 17.

In this case, the amount of ‘tax sought to be evaded’ means the tax assessed on the net wealth. In any other case, it means the difference between the tax on the net wealth assessed and the tax chargeable on the wealth disclosed by the assessee.

Further, in the case of failure of an assessee to offer an explanation in respect of any facts material to the computation of his net wealth or the explanation offered by him being found by the concerned assessing authority to be false or where he is not able to substantiate his explanation and fails to prove the bona fides of such
explanation, the consequential deduction or disallowance in computing his net wealth shall be deemed to represent the value of the assets in respect of which the particulars have been concealed.

Any bullion, money, jewellery or other valuable article or thing found in the course of search and claimed by the assessee as forming or representing parts of his net wealth are deemed to have been concealed by him if the assets have not been declared in the return of wealth furnished before the date of search for the valuation date falling before or after the date of search unless the assets are recorded either before the date of search or specified in the books of account maintained by him or disclosed to the Commissioner before the date of search or the assessee declares such assets in the course of search, specifies the manner of acquisition thereof and pays tax and penalty thereon.

Explanation 6 clarifies that the circumstance where any additional tax is charged as a consequence of rectification of arithmetical error, exemptions or deductions allowed/disallowed on the basis of the information available in the return of wealth does not tantamount to concealment.

Sub-section (3) makes the prior approval by the Joint Commissioner compulsory for the following cases: (i) where the penalty exceeds ₹ 10,000 and the concerned assessing authority is the Income-tax Officer; (ii) where the penalty exceeds ₹ 20,000 and the concerned assessing authority is the Assistant Commissioner or Deputy Commissioner.

Sub-section (5) lays down that no order imposing the penalty under this Section shall be passed in a case where the assessment to which the proceedings for imposition of penalty relate is the subject matter of an appeal under Section 23 or 24; after the expiry of the financial year in which the proceedings, in the course of which action for imposition of penalty has been initiated, are completed or 6 months from the end of the month in which the order of assessing authority i.e. the Commissioner (Appeals) or ITAT is received by the Chief Commissioner or Commissioner whichever is later. Where the relevant assessment is subject matter of revision under Section 25(2), the order imposing penalty shall not be passed after the expiry of six months from the end of the month in which such order or revision is passed. In any other case, the penalty order cannot be passed after the expiry of the financial year in which the proceedings in course of which action for imposition of penalty has been initiated, are completed or six months from the end of the year in which action for imposition of penalty is initiated, whichever period expires later.

In computing the above periods of limitation, the period during which immunity is granted under Section 22H; the time taken in giving an opportunity to the assessee to be reheard under Section 39 and the period during which a proceeding for levy of penalty is stayed by an order or injunction of any court shall not be taken into account.

*Explanation: Where the value of any asset returned by the assessee is less than 70% of the value of such asset as determined in the assessment, such person shall be deemed to have furnished inaccurate particulars of such asset, unless he proves that the value of the asset as returned by him is the correct value.
(2) Failure to Pay Tax (Section 31)

When an assessee fails to pay tax demanded of him during the prescribed time (30 days), he shall be liable by way of penalty, to pay such amount as the Assessing Officer may direct and in case of continuing default, such other sum as directed from time to time. However, the total amount of penalty can not exceed the amount of tax in arrears.

Where the Assessing Officer is satisfied that the default was for good and sufficient reasons, no penalty shall be levied on the assessee.

Test Your Knowledge

What is the minimum and maximum amount of penalty payable if a person has failed to pay the amount of Wealth-tax?

(a) 1,000 minimum and 25,000 maximum
(b) 10,000 minimum and 20,000 maximum
(c) 500 minimum and 10,000 maximum
(d) 5,000 minimum and 15,000 maximum

Correct answer: (a)

10.15 POWER TO REDUCE OR WAIVE PENALTY (SECTION 18B)

The Commissioner is empowered to reduce or waive the amount of penalty imposed or imposable on an assessee either on his own motion or otherwise, in the following cases:

(i) Concealment of the particulars of his wealth or furnishing of inaccurate particulars of assets or debts.

The Commissioner would reduce or waive the penalty subject to the following conditions:

(i) in case of (i) above, the assessee has furnished particulars regarding the concealed wealth or particulars in respect of any asset or debt voluntarily and in good faith prior to the detection by the Assessing Officer of the concealment or inaccurate particulars of assets or debts.

(ii) he has co-operated with the department in any enquiry relating to assessment.

(iii) he has paid or made satisfactory arrangements for the payment of tax or interest payable in respect of the relevant assessment year.

Where the assessee conceals the particulars of his wealth and the amount of wealth so concealed for any one of the relevant assessment years exceeds ₹ 5,00,000, the Commissioner cannot reduce or waive the penalty, without the previous approval of the Chief Commissioner or Director General. However, where the Commissioner has reduced or waived the penalty once in relation to one or more assessment years, the assessee shall not be entitled to any relief again for other assessment years.
Further, Section 18B(4) empowers the Commissioner to grant relief to an assessee on his application and after recording the reasons for doing so by (i) reducing or waiving every kind of penalty payable under the Wealth-tax Act, or (ii) staying or compounding recovery proceedings in respect thereof. This right should be exercised by the Commissioner in deserving cases which satisfy the following conditions:

(i) if it is not done, it would cause genuine hardship to the assessee, and
(ii) the assessee has co-operated in any inquiry relating to assessment or recovery proceedings.

An order of the Commissioner (under Section 18B) reducing or waiving the penalty shall be final and shall not be called into question before any court or any other authority.

10.16 OFFENCES AND PROSECUTIONS (SECTIONS 35A TO 35N)

There are certain lapses on the part of the assessee for which the wealth-tax authority at the instance of the Commissioner, may launch prosecution proceedings against him in the court. In that case the Magistrate (Metropolitan or first class) shall penalise the assessee and not the department. However, the Commissioner may, either before or after the institution of proceedings compound any offence.

The prosecution proceedings may be instituted against the defaulter assessee in various cases explained in the succeeding paragraph, other than these sections which are already discussed (Section 35A to Section 35G):

(1) Wilful Attempt to Evade Tax etc. (Section 35A)

If a person willfully attempts to evade any tax, penalty, or interest or payment thereof, he shall be liable to pay penalty as well as prosecution as stated in the table under heading IX hereinbefore.

A wilful attempt to evade any tax, penalty or interest etc., or the payment thereof shall include a case where any person:

(i) has, in his possession or control any books of account or documents containing a false entry or statement; or
(ii) makes, or causes to be made, any false entry or statement in such books of account or documents; or
(iii) wilfully omits, or causes to be omitted, any entry or statement in the books of account or documents; or
(iv) causes any other circumstances to exist which will have the effect of enabling him to evade the tax, penalty or interest.

(2) Failure to Furnish Returns of Net Wealth (Section 35B)

If a person wilfully fails to furnish in due time the return of net wealth under Section 14(1) or 14(2) or 17(1), he shall be punishable with both penalty and prosecution. For details see the Table under heading IX hereinbefore.

However, a person shall not be proceeded against for failure to furnish in due
time the return of net wealth under Section 14(1) in the following cases:

(a) for any assessment year commencing prior to 1.4.1975;
(b) for any assessment year commencing after 31.3.1975; if
   (i) the return is furnished by him before the expiry of the assessment year;
   or
   (ii) the tax payable by him, determined on regular assessment, does not exceed ₹ 3,000.

(3) Failure to Produce Accounts and Documents (Section 35C)

If a person wilfully fails to produce accounts, records and documents referred to in a notice issued under Section 16(4) on the date specified in the notice, he shall be punishable with rigorous imprisonment as well as fine. (See the Table under heading IX hereinbefore)

(4) False Statement in Verification (Section 35D)

If a person makes a statement in any verification (other than the registration of valuer) or delivers an account or statement which is false, and which he knows to be false or does not believe to be true, he shall be punishable with prosecution/penalty highlighted under heading IX hereinbefore.

(5) False Statement in Verification by Registered Valuers (Section 35E)

If a Registered Valuer makes a statement in verification which he either knows or believes to be false, or does not believe to be true, he shall be punishable with imprisonment for a term which may extend to 6 months or with fine or with both. (Also given in Table under heading IX hereinbefore.)

(6) Failure to furnish particulars under Section 34ACC (Section 35EE)

If a person referred to in Section 34ACC, i.e., a registered valuer, fails to intimate to the Board the particulars of conviction or finding referred to in the said section, he shall be punishable with rigorous imprisonment and also liable to fine. But, if such person proves that there was reasonable cause or excuse for the said failure, he shall not be punishable. (For details see the Table under heading IX hereinbefore.)

(7) Contravention of order made under Section 37A (Section 35EEE)

Section 35EEE, provides for punishment with rigorous imprisonment (See Table under heading IX) and also imposition of fine in the event of contravention of the provisions of Section 37A, second proviso to Sub-section (1) and sub-section (3A) pertaining to orders of the Assessing Officer to assesse not to remove, part with or otherwise deal with the immovable properties, except with the previous permission of the concerned officer.

(8) Abetment of False Return, etc. (Section 35F)

If a person abets or induces any other person to make and deliver an account, statement or declaration relating to any net wealth chargeable to tax which is false and which he either knows to be false or does not believe to be true, or induces any person to evade tax, he shall be punishable with prosecution and fine specified under heading IX.
(9) **Punishment for Second and Subsequent Offences (Section 35G)**

If any person convicted of an offence mentioned in 1, 2, 4 and 7 above is again convicted of the same offence, he shall be punishable for the second and every subsequent offence with rigorous imprisonment for at least 6 months but which may extend to seven years and with fine.

(10) **Offences by H.U.F. (Section 35H)**

Where an offence under this Act has been committed by a H.U.F., the karta thereof shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence, he shall not be punished. Where it is proved that the offence has been committed with the consent or connivance of or is attributable to any neglect on the part of any member of the family, such member shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(11) **Offences by companies (Section 35HA)**

The Finance Act, 1992 has inserted this new Section 35HA with effect from the assessment year 1993-94. As companies have also been brought under the wealth tax net with effect from assessment year 1993-94 this new Section 35HA lays down the penalty where an offence has been committed by a company. Thus according to this section every person who at the time the offence was committed, was incharge of and was responsible to the company for the conduct of the business of the company as well as the company will be liable to be proceeded against and punished accordingly.

However, no such person shall be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Further, this section also defines the term ‘company’ to include a firm and an association of persons or body of individuals whether incorporated or not.

W.e.f. 1.10.2004, where an offence has been committed by a Person, being a company and such offence is punishable with imprisonment and fine, then without prejudice to the aforesaid provisions such company shall be punishable with fine and every person referred to in sub-section (1) or the director, manager, secretary or other officer of the company referred to in sub-section (2), shall be liable to be proceeded against and punished in accordance with the provisions of this Act.

(12) **Prosecutions to be at the instance of Chief Commissioner or Commissioner and power of Chief Commissioner to compound offences (Section 35-I)**

A person shall not be proceeded against for an offence under the Wealth-tax Act, 1957 except with the previous approval of the Commissioner or Commissioner (Appeals). The Chief Commissioner/Director General have been empowered to issue such instructions/directions with regard to prosecution matters as they may deem fit. They have also been empowered to compound any offence either before or after the institution of proceedings.
(13) Certain offences to be non-cognizable (Section 35J)

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, an offence punishable under Section 35A or Section 35B or Section 35D or Section 35F shall be deemed to be non-cognizable within the meaning of that Code.

(14) Bar on Prosecution (Section 35K)

A person shall not be prosecuted for an offence under 1 and 4 above (Sections 35A and 35D) in relation to the assessment for an assessment year in respect of which the penalty imposed or imposable under Section 18(1)(iii) has been reduced or waived under Section 18B. Further, any statement made or account or other document produced by the offender before any wealth-tax authority, not being an Inspector of Income-tax, shall not be inadmissible as evidence for prosecution proceedings merely on the ground that it was made or produced in the belief that the penalty would be reduced or waived or the offence would be compounded.

(15) Jurisdiction of Courts (Section 35L)

No court inferior to that of a Metropolitan Magistrate or a Magistrate of the first class shall try any offence under this Act.

(16) Section 360 of the code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958 not to apply (Section 35M)

Nothing contained in Section 360 of the Code of Criminal Procedure, 1973, or in the Probation of Offenders Act, 1958, shall apply to a person convicted of an offence under this Act unless that person is under eighteen years of age.

(17) Immunity from Prosecution (Section 36A)

The Central Government may grant immunity to potential supplier of valuable information, data and evidence on the basis of which tax-evaded wealth may be discovered and due taxes, penalty, etc., recovered from the tax-evader concerned. Such immunity extends to prosecution for the offences and penalty under the Wealth-tax Act. However, if the person does not comply with the conditions on which the immunity was granted or willfully conceals anything or gives false evidence, the Government, after recording the reasons in writing for doing so, may withdraw the immunity granted. Then, the person may be tried for any offence and be liable to any penalty imposable under this Act.

Test Your Knowledge

Which of the following offences is considered under Section 35E?
(a) Wilful Attempt to Evade Tax etc.
(b) False Statement in Verification
(c) Failure to Produce Accounts and Documents
(d) False Statement in Verification by Registered Users

Correct answer: (d)
LESSON ROUND UP

- This Chapter deals with various facets of Wealth Tax Act, 1957.
- At the inception it deals with charging section for Individual and HUF which is followed by the incidence of the wealth tax.
- After the provisions of computation of net wealth discussed.
- Under the heading of computation of net wealth, the provisions of assets, assets are given which are belonging to others but included in the income of an individual, provided of Assets which are exempt under the Wealth Tax Act, debt and liabilities and valuation of assets discussed.
- All matters relating to assessment, return, payments and refund under the wealth Tax Act are dealt.
- Lastly the penalty provisions under the Wealth Tax Act, 1957 are discussed.

SELF TEST QUESTIONS

1. What are the units of assessment under the Wealth-tax Act, 1957?
2. What is the nexus between the taxable wealth and residential status of an assessee as regards tax incidence? Does it make any difference if the assessee is: a resident, non-resident, and, resident but not ordinarily resident? Illustrate.
3. What do you understand by ‘deemed assets’? State the assets to which the deeming provisions of the Wealth-tax Act are applicable.
4. (a) Are there any assets exempt from Wealth-tax?
(b) Are the following assets liable to Wealth-tax?
   (i) An asset located outside India.
   (ii) The property held by the assessee under trust or other legal obligation for charitable purposes.
   (iii) The interest of the assessee in the coparcenary property of the H.U.F.
   (iv) House Property
(v) Agricultural building  
(vi) Life Insurance Policy  
(vii) Trees  
(viii) Deposits in Post-Office Savings Bank A/c ₹ 30,000  
(ix) Equity shares of company  
(x) Units of the Unit Trust of India  
(xi) Bank balance on the valuation date  
(xii) Race horse.


6. In what circumstances is the value of property transferred to a spouse, of the transferor includible in the transferor’s net-wealth?

7. Write short notes on:
   (i) Net wealth.
   (ii) Valuation date.
   (iii) Rounding off of net wealth and the wealth-tax.
   (iv) Specified area.
   (v) Valuation of jewellery.

8. Describe the steps involved in valuation of house property as per Schedule III of the Wealth-tax Act, 1957.

9. How would you determine the value of the following:
   (1) Assets of Business.
   (2) Jewellery.
   (3) Interest in a firm or an association of persons.

10. State the debts which are not deductible in computing the net wealth of an assessee.

11. (a) Are there any concessions in Wealth-tax? Briefly state the same.
    (b) Why is determining of location of assets and liabilities necessary?

12. Are the following assessable to wealth-tax and, if so, at what status?
    (i) Association of persons;
    (ii) Public Charitable Trust.

13. Who is liable to pay wealth-tax after the partition of a Hindu Undivided Family?


15. Who can rectify a mistake and at whose request? Mention the time limit for rectification of a mistake.

16. The Assessing Officer discovers that wealth has escaped assessment. What steps are open to him to remedy the defect and what are the time limits for taking such steps?
17. If a person fails, without reasonable cause, to furnish a return of his net wealth, he lays himself open to three types of punishments. What are those?

18. Enumerate the penalties leviable in the following cases:
   (i) Failure to pay tax on the basis of "Self-assessment".
   (ii) Concealment of assets or furnishing inaccurate particulars of assets or debts.
   (iii) Failure to pay tax on demand.
   (iv) Failure to answer questions demanded of him.

19. What are the provisions of the Wealth-tax Act regarding prosecution in the following cases:
   (i) Wilful attempt to evade tax.
   (ii) Failure to furnish return of net wealth.
   (iii) Abetment of false return, etc.
   (iv) False statement in verification by a Registered Valuer.

20. Under what circumstances, the Commissioner may revise the orders passed by any authority subordinate to him under Wealth Tax Act, 1957? Can he pass an order prejudicial to the assessee, when he revises the order at the request of the assessee?
In present day, services covered wide range of activities such as management, insurance, whole-sale distribution and retailing including research and development activities. The share of service sector to our GDP is increasing faster than those in the other developing countries. The Tax Reform Committee headed by Dr. Raja C. Chelliah as recommended the imposition of tax on services as a measure for broadening the tax base of the Indirect Tax in our country. As a result vide Finance Act, 1994 a beginning has been made in the Chapter V of the Income Tax Act by imposing tax on some services. After that in every Finance Act new services are being included within the Service Tax bracket.

**LEARNING OBJECTIVES**

The objective of this chapter is to discuss the following:

- Background
- Constitutional Validity
- Scope
- Administrative Mechanism
- Categories of Services
- Rate of Service Tax
- Computation of Tax

**11.1 BACKGROUND**

As the economy grows and develops, the contribution of the services sector becomes more substantial. Hence, tax on services becomes substantial revenue for the Government. Although Service tax is a concept of the modern era where developed economies as well as developing economies find over 70% of their gross economic output coming from the services sector. Service tax was there in vogue even in the Mauryan period in India. Ms. Romila Thaper in her "Asoka and the Decline of the Mauryas", at page 72 (London 196, paperback edition, 1997, by Oxford) points out that services of weapon and implement makers were required to be provided to the state for a certain number of days in a year. This was a form of service tax in that period. But in the modern context, because of the increasing
contribution of the service sector to the GDP of an economy, the importance of contribution of the services sector to the GDP of an economy, the importance of service tax is growing. As under the WTO agreements governments are required to reduce customs tariffs, governments are considering increase in service taxes revenues as a compensatory revenue generation mechanism.

The Tax Reforms Committee headed by Dr. Raja J Chelliah recognized the revenue potential of the service sector and recommended imposition of service tax on select services. Consequently the service tax was imposed at a uniform rate of 5% in the Union Budget for 1994-95 on services. In every Finance Act there are some amendments to the service tax mechanism by which other services which are not yet included in tax brackets are added. The service tax is now at 10% with education cess and Secondary & Higher Education (SHE) cess at 2% and 1% respectively.

In terms of economics, tax on services is an indirect tax. This is because the burden of service tax can be passed on to the customer i.e., the recipient of the service. The service provider may also bear the burden of the tax by not charging the service tax separately in the invoice.

11.2 CONSTITUTIONAL VALIDITY

Service Tax is levied under Union Government’s power to tax vide Entry 92C (Taxes on services) of List I of Schedule VII of the Constitution of India. There is no separate enactment for the levy of Service Tax.

Sections 64 to 96 of Chapters V and VA of the Finance Act, 1994 provide for the legal basis for the levy and collection of Service Tax in India. The provisions of Service Tax were brought into force w.e.f. July 01, 1994. Service Tax extends to whole of India except the State of Jammu & Kashmir.

Article 265 of the Constitution lays down that no tax shall be levied or collected except by the authority of law. Schedule VII divides this subjects into three categories—

(a) Union list (only Central Government has power of legislation)
(b) State list (only State Government has power of legislation)
(c) Concurrent list (both Central and State Government can pass legislation).

To enable parliament to formulate by law principles for determining the modalities of levying the Service Tax by the Central Government & Collection of the proceeds there of by the Central Government & the State, the amendment vide constitution (95th Amendment) Act, 2003 has been made. Consequently, new article 268A has been inserted for Service Tax by Union Government collected and appropriated by the Union Government and amendment of seventh schedule to the constitution, in list I-Union list after entry 92B, entry 92C has been inserted for taxes on services as well as in Article 270 of the constitution the Clause (1) Article 268A has been included.

Limbs of Service Tax Laws

Certain provisions of the Central Excise Act, 1944 also apply to Service Tax. The various limbs of the Service Tax Law are:

1. The provisions of the Finance Act, 1994 as amended by successive Finance
2. Service Tax Rules, 1994, as amended from time to time;
3. The CENVAT Credit Rules, 2004 replaced the Service Tax Credit Rules, 2002;
4. Statutory Notifications on service tax issued by the Government;
5. Circulars on service tax issued by the CBEC;
6. Trade Notices issued by jurisdictional Commissionerates of Central Excise or service Tax on service tax matters;
7. Export of Services Rules, 2005;
8. Taxation of Services (provided from Outside India and Received in India) Rules, 2006;

11.3 SCOPE

Only three services namely telephone, stock broker and general insurance services were brought into the tax net. The Finance Act, 1996 enlarged the scope of the service tax to cover additionally, advertising, pager and courier services. The subsequent Finance Act gradually went on increasing the number of taxable services. The Finance Act, 1994 applies all over India except the state of Jammu & Kashmir. That means all services received and consumed on the territory of J&K are non taxable.

11.4 ADMINISTRATIVE MECHANISM

The Central Excise department administers Service Tax. A separate cell called the Service Tax Cell, under each Commissionrate of Central Excise has been created for the purpose. However, in six cities, separate service tax commissionerates have been created.

Test Your Knowledge

Which of the following services was brought into the tax net after the amendment of Finance Act, 1996?

(a) General insurance
(b) Telephone
(c) Advertising
(d) Stock broker

Correct answer: (c)

11.5 CATEGORIES OF SERVICES

Primarily, the terms of the sub-clauses of Clause (105) of Section 65 of the Finance Act determine the classification of taxable services. However, Section 65A contains provisions related to classification in case of overlapping of taxable services.

11.6 RATE OF SERVICE TAX

In the year 1994, when Service Tax was first introduced, it was first levied on the
uniform basis at the rate of 5% of the value of taxable services. The rate went up to 8% subsequently vide Finance Act, 2003 w.e.f. May 14, 2003. W.e.f. 10.9.2004, the rate of service tax was raised to 10% on the value of the taxable services. The rate of service tax was further raised to 12% by the Finance Act, 2006. Presently, the rate of service tax is 10% w.e.f from 24th February 2009., In addition to it, education cess at the rate of 2% of the amount of service tax also applies. From the Financial Year 2007-08 higher and secondary education cess @ 1% has also been levied.

11.7 COMPUTATION OF TAX

An example: If a person renders a taxable service of the value of ₹500, the service tax @10% will be ₹50. The education cess and Secondary & Higher education cess @3% on ₹50 will be ₹1.50. The total tax will be ₹51.50.

Where the gross amount charged by a service provider is inclusive of service tax payable, the value of taxable service shall be such amount as with the addition of tax payable, is equal to the gross amount charged. Service tax is levied on services provided within the territory of India including territorial waters of India extending upto 12 nautical miles (under International Sea Act). And hence services provided beyond the territorial waters of India are not liable to service tax as the provisions of the service tax has not been extended to such areas so far.

Test Your Knowledge

When service tax was first introduced in the year 1994, it was levied on a uniform basis.

- True
- False

Correct Answer: True

In the year 1994, when service tax was first introduced, it was first levied on a uniform basis at the rate of 5% of the value of taxable services.

LESSON ROUND UP

- The Tax Reform Committee headed by Dr. Raja C. Chelliah recognised the revenue potential of service sector and recommended imposition of service tax on some select services.
- The Constitutional validity of service tax has been upheld by the Gujarat High Court in a recent case.
The Central Excise Department has been entrusted with the task of administration of service tax.

The Central Government has the prerogative in imposing service tax on new services or increasing its rate through the Finance Acts.

**SELF TEST QUESTIONS**

1. Describe briefly the scope of service tax in India.
2. Define the following:
   (a) Taxable service;
   (b) Service tax.
3. Describe briefly the mechanism in administering service tax in India.
4. Explain briefly the procedure of computing service tax on Taxable Services.
STUDY XII

LEY, COLLECTION AND PAYMENT OF SERVICE TAX
ALONG WITH CENVAT CREDIT RULES

This chapter covers the entire procedural as well substantive provisions relating to levy, collection and payment of service tax and relevant CENVAT Credit Rules 2004. It also covers the registration aspects, filing aspects including e-filing, appeal matters including appeal before Appellate Tribunal.

LEARNING OBJECTIVES

This chapter covers the following topics:

- Payment of Tax
- Reverse Charge
- Basis of charge and Due Date for payment of service tax
- Point of Taxation Rules, 2011
- Registration
- Service Tax Registration of Special Category of Persons
- Exemption
- Records to be maintained
- Adjustment of Service Tax
- E-filing of Service Tax Returns
- Returns under Service Tax
- Recovery of Service Tax
- Provisional attachment pending adjudication
- Amount collected representing as service tax must be paid to Government
- Interest on delayed payment of service tax u/s 75
- Doctrine of unjust enrichment
- Penalties
- Waiver or reduction of penalty
- Advance Ruling
- CENVAT Credit Rules, 2004
- Appeals
- Appeals to Commissioner (Appeals)
- Appeals to Tribunal
- Cross objection should be in Form ST-6 in quadruplicate
- Role of Practising Company Secretary
- Service Tax on Practising Company Secretary
12.1 PAYMENT OF SERVICE TAX

— Section 66 of the Finance Act, 1994 imposes service tax on services specified under the sub-clauses of Section 65(105).
— It is imposed on services provided or to be provided (in future).
— The amount of service tax is calculated on the basis of value determined under Section 67 of the Act.
— If the value can not be determined as per Section 67, valuation shall be made on the basis of Valuation Rules, 2006.

12.2 REVERSE CHARGE

As per Section 68, every person providing taxable services i.e. provider of output service is liable to pay service tax. But in special cases service receiver is liable to pay service tax. This is also known as reverse charge.

As per Rule 2(1)(d) of Service tax Rules, 1994 the following receivers of service are liable to pay service tax:
(i) In general Insurance or Life Insurance services, the person carrying on the business of Insurance is liable and not the insurance agent.
(ii) In the case of services received in India from a place or person outside India, the recipient is liable.
(iii) In specified cases consignor or consignee who is paying freight charges is liable to pay service charge for the services received from a Goods Transport Agency.
(iv) In case mutual fund services, the mutual fund or asset management company is liable and not the agent.
(v) For sponsorship services, the recipient body corporate or firm is liable.

12.3 BASIS OF SERVICE TAX AND DUE DATE FOR PAYMENT OF SERVICE TAX

With effect from 1st April 2011, Finance Act, 2011 introduced Point of Taxation (POT) Rules, 2011. These rules laid down the provisions relating to payment of service tax on accrual basis instead of receipt basis and specify the relevant date for determining rate of service tax.

CBEC issued a circular MF(DR)DO F.NO.334/3/2011-TRU dated 28-02-2011 clarifying that the time of provision of service will be earliest of the following dates: (a) Date on which service is provided or to be provided (ii) Date of invoice (iii) Date of Payment.

W.e.f 1-04-2011 Rule 6(1) of the Service Tax Rules, 1994 has been amended., which provides that the service tax is to be paid to the credit of the Central Government by the 5th of the month immediately following the calendar month in which service is deemed to have been provided as per POT Rules made in this regard. However, where the assessee is an individual or proprietary firm or partnership firm, the service tax shall be paid to the credit of the Central Government by the 5th of the month immediately following the quarter in which service is deemed
to have been provided as per POT Rules made in this regard. Where payment is made through internet banking, such e-payment can be made by 6th of the month.

POT Rules, 2011 make provisions in respect of date when a service shall be “deemed to be provided”.

31st March will be the due date of payment for the month of March or for the quarter ending March.

The assessee, who has paid service tax of rupees 10 lakh or above in the preceding financial year or has already paid service tax of rupees 10 lakh in the current financial year, shall be liable to pay service tax electronically.

Further, notwithstanding the time of receipt of payment towards the value of services, no service tax is payable for the part or whole of the value of services, which is attributable to services provided during the period when such services were not taxable.

Rule 6(2) prescribes that the assessee shall deposit the service tax liable to be paid by him with the bank designated by the Central Board of Excise and Customs in Form TR-6 or in any other manner prescribed by the Central Board of Excise & Customs.

Date of deposit of cheque will be treated as date of payment subject to realization of the cheque.

12.4 POINT OF TAXATION (POT) RULES, 2011

1. Point of taxation means the point in time when a service shall be deemed to have been provided. This Point of time will determine rate of service tax and due date of payment of service tax.

As per Rule 3 point of taxation shall be (a) the time when the invoice for service provided or to be provided is issued,(b) in case where payment is received before the issue of invoice then the time when such payment is received and (c) where advance is received by the service provider the time of receipt of such advance.

Rule 4A of the Service Tax Rules, 1994, provides that every person providing taxable service shall issue invoice within 14 days of completion of service or receipt of service whichever is earlier. Further proviso to Rule 3 of POT Rules, provides that where the invoice is not issue within 14 days of completion of service than the point of taxation shall the date of completion of such service.

Examples:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Date of Completion of service</th>
<th>Date of Invoice</th>
<th>Date on which payment is received</th>
<th>Point of taxation</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>April 10, 2011</td>
<td>April 20, 2011</td>
<td>April 30, 2011</td>
<td>April 20, 2011</td>
<td>Invoice is issued within 14 days and before payment</td>
</tr>
</tbody>
</table>
2. Rate of service tax:

W.e.f 1.4.2011, Rule 5B of Service Tax Rules, 1994, provides that the rate of tax in case of services provided or to be provided shall be rate prevailing at the time when the services are deemed to have been provided under the rules made in this regard.

3. Continuous supply of service:

“Continuous supply of service” means any service provided or to be provided continuously for a period exceeding three months. Further, Central Government may notify provision of a particular service to be considered as continuous supply of service.

The following services have been notified as continuous supply of service irrespective of period for which they are provided or to be provided vide Notification No. 28/2011.

(a) Telecommunication service
(b) Commercial or industrial construction
(c) Construction of residential complex
(d) Internet Telecommunication service
(e) Works contract services

In case of continuous supply of service, the point of taxation shall be the date of completion of the events as specified in the contract or time when invoice for the service provided or to be provided is issued or the date on which payment received whichever is earlier. Where any advance is received by the service provider the point of taxation shall be date of receipt of each such advance.

4. Point of Taxation in case of specified services or persons:

The Point of Taxation in respect of;

(a) the services covered by sub-rule (1) of rule 3 of Export of Services Rules, 2005.
(b) the persons required to pay tax as recipients of services.

(c) Individual or firms providing taxable services as Practicing Chartered Accountants, Practicing Cost Accountant, Practicing Company Secretaries, Advocates, Architects, Interior Decorators, Scientist and Technocrats shall be the date on which payment is received or made.

In the case of associated enterprises, where the person providing the service is located outside India, the point of taxation shall be the date of credit in the books of account of the person receiving the service or date of making the payment whichever is earlier.

However in case of Export of services payment is not received within the period specified by RBI then point of taxation shall be determined as per Rule 3,4,5,6 or 8 as applicable.

Where payment not made within six months of date of invoice of service provided in case where the service tax is paid by the recipient the point of taxation shall be determined as per Rule 3,4,5,6 or 8 as applicable.

5. Applicability and Transitional Provision [Rule 9]:

These rules shall not apply (a) where the provision of service is completed or (b) where invoices are issued prior to 1.4.2011.

Where the provision of services completed on or before 30-06-2011 or invoice issued before 30-06-2011 then the point of taxation shall be issue of invoice or date of receipt of payment at the option of tax payer.

Test Your Knowledge

Where payment for service tax is made through internet banking, such e-payment can be made by the ______ of the month, immediately following the quarter in which the payments are received.

(a) 5th  
(b) 6th  
(c) 8th  
(d) 10th

Correct answer: (b)

12.5 REGISTRATION

Section 69 of the Finance Act, read with Rule 4 of the Service Tax Rules make provisions relating to registration. It is mandatory for every person liable to pay service tax to get registered with Superintendent of Central Excise. A person providing a taxable service is liable to pay service tax in terms of Section 68.
12.5.1 Who Shall Apply?

An application for registration to the Superintendent of Central Excise can be made in form (ST-1). This is to be made within a period of thirty days from the date on which the service tax is leviable.

ST-1 Form shall be accompanied by the following documents:

— Permanent Account number (PAN);
— An affidavit declaring the commencement of the services;
— Copy of passport/ration card etc., showing proof of residence;
— Passport size photograph of the assessee in case of an individual. In case of partnership firm, copy of partnership deed duly certified to be true copy along with registration certificate in case the firm is registered;
— In case of corporate assessee, copy of memorandum, articles of association duly certified to be true copy by the director.

12.5.2 Single Registration for Multiple Services

In case the taxable services are provided from more than one premises/offices, the assessee can opt for registration for only one premises if there is a system of centralised billing/centralised accounting with permission from Department. Where an assessee is providing more than one taxable service, he can obtain registration by making a single application mentioning all the taxable services provided by him.

Where an assessee seeks to obtain single registration for more than one premises, he has to apply before the Chief Commissioner/Commissioner of Central Excise if all the offices are falling under the jurisdiction of one Chief Commissioner/Commissioner or before the Director General of Service Tax (DGST) if his offices are falling under the jurisdiction of more than one chief commissioners. Registration application before the DGST shall be submitting through the jurisdictional office of the Assistant/Deputy Commissioner of Central Excise.

12.5.3 Issue of Registration Certificate

The Superintendent of Central Excise is bound to grant a certificate of registration in Form ST-2 with in 7 days of the date of receipt of the application. This certificate shall indicate the details of all the taxable services provided by the service provider. In case of transfer of business by the assessee to another person, the transferee is required to obtain a fresh Certificate of Registration.

12.5.4 Surrender of Certificate of Registration

The registered assessee who ceases to provide the taxable services for which he had been registered shall surrender his Certificate of Registration to the concerned Superintendent of Central Excise. There may also be a partial surrender where some of the services rendered by the assessee are discontinued. In such case, he shall intimate it to the concerned Superintendent of Central Excise to get it endorsed on the registration certificate.
Test Your Knowledge

Any provider of taxable service whose aggregate value of taxable service in a financial year exceeds ______ shall make an application for registration to the jurisdictional Superintendent of Central Excise.

(a) ₹ 3,00,000
(b) ₹ 5,00,000
(c) ₹ 7,00,000
(d) ₹ 9,00,000

Correct answer: (d)

12.6 SERVICE TAX REGISTRATION OF SPECIAL CATEGORY OF PERSONS

Service Tax (Registration of Special Category of Persons) Rules, 2005 have come into effect on 16th day of June, 2005.

Registration

Registration under these rules can be obtained by an input service distributor by making an application to the jurisdictional Superintendent of Central Excise in such form as specified by the Board within a period of thirty days of the commencement of business or the 16th day of June, 2005, whichever is later.

Any provider of taxable service whose aggregate value of taxable service in a financial year exceeds nine lakh rupees shall make an application to the jurisdictional Superintendent of Central Excise in the prescribed form for registration within a period of thirty days of exceeding the aggregate value of taxable service of nine lakh rupees.

12.6.1 Furnishing of Return

The input service distributor shall furnish a return to the jurisdictional Superintendent of Central Excise in such form and at such intervals as prescribed under Rule 9(10) of CENVAT Credit Rules, 2004. The CENVAT Credit Rules prescribe half yearly returns to be submitted by month end from the close of the half year.

The term, “aggregate value of taxable service” means the sum total of first consecutive payments received during a financial year towards the gross amount, as prescribed under Section 67 of the Act, charged by the service provider towards taxable services but does not include payments received towards such gross amount which are exempt from the whole of service tax leviable thereon under Section 66 of the Act under any notification other than Notification No. 6/2005-Service Tax, dated the 1st March, 2005 [G.S.R. 140(E), dated the 1st March, 2005].
The term, “input service distributor” shall have the meaning assigned to it in Clause (m) of Rule 2 of the CENVAT Credit Rules, 2004.

12.7 EXEMPTION

The Central Government by virtue of Notification No. 22/2006-Service Tax dated 31st May, 2006 exempted the following taxable services from the whole of the service tax leviable thereon under Section 66 of the said Finance Act, namely:

(i) taxable services provided or to be provided to any person, by the Reserve Bank of India;

(ii) taxable services provided or to be provided by any person, to the Reserve Bank of India when the service tax for such services is liable to be paid by the Reserve Bank of India under Sub-section (2) of Section 68 of the said Finance Act read with Rule 2 of the Service Tax Rules, 1994;

(iii) taxable services received in India from outside India by the Reserve Bank of India under Section 66A of the Finance Act, 1994.

12.8 RECORDS TO BE MAINTAINED

Every assessee is required to furnish to the Superintendent of Central Excise at the time of filing his return for the first time, a list of all accounts maintained by him in relation to service tax including memoranda received from his branch offices. All types of records including computerized data as maintained by an assessee as per various laws in force from time to time shall be acceptable.

Rule 5(1) of the Service Tax Rules, 1994 makes acceptable the records (including computerized data) as maintained by an assessee in accordance with the various laws in force. Further, every assessee is required to furnish to the Superintendent of Central Excise at the time of filing his return for the first time a list of all accounts maintained by the assessee in relation to service tax including memoranda received in branch offices [Rule 5(2)].

12.9 ADJUSTMENT OF SERVICE TAX

Where an assessee has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter.

The adjustment of excess amount paid, shall be subject to the following conditions, namely:

(i) excess amount paid is on account of reasons not involving interpretation of law, taxability, classification, valuation or applicability of any exemption notification,

(ii) excess amount paid by an assessee registered under Rule 4(2), on account of delayed receipt of details of payments towards taxable services may be adjusted without monetary limit,

(iii) in cases other than specified in clause (ii) above, the excess amount paid
may be adjusted with a monetary limit of ₹ 2,00,000 for a relevant month or quarter as the case may be.

(iv) the details and reasons for such adjustment shall be intimated to the jurisdictional Superintendent of Central Excise within a period of fifteen days from the date of such adjustment.

Where the person liable to pay service tax in respect of services provided or to be provided in relation to renting of immovable property has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter on account of non-availment of deduction of property tax paid in terms of notification No.24/2007-Service Tax, dated the 22nd May, 2007, from the gross amount charged for renting of the immovable property for the said period at the time of payment of service tax, the assessee may adjust such excess amount paid by him against his service tax liability within one year from the date of payment of such property tax. The details of such adjustment shall be intimated to the Superintendent of Central Excise having jurisdiction over the service provider within a period of fifteen days from the date of such adjustment.

12.10 RETURNS UNDER SERVICE TAX

Rule 7 of the Service Tax Rules,1994 return under Service Tax is required to be filed by every assessee on half yearly basis in Form ST-3 or Form ST-3A, as the case may be, along with a copy of the Form TR-6, in triplicate for the months covered in the half-yearly return.

Every assessee shall submit the half yearly return by the 25th of the month following the particular half-year.

12.10.1 E-Filing of Service Tax Returns

The Government allowed filing of service tax return electronically from April 2003 on only ten select classes or group of service tax providers on optional basis, now from January 2004 it is extended to all the taxable services. This facility is available on the website http://servicetaxefiling.nic.in. Assesses having a 15-digit Service Tax Payers (STP) code can avail of the facility of electronic filing of their return. Now, vide Notification No. 43/2011 dt. 25th August 2011, every Assessee shall submit a half yearly return electronically. The assessee is thereupon provided a unique user name and password. The assessee gets a computer-generated acknowledgement for evidence of having filed the return.

12.10.2 Revision of Returns:

An assessee may submit a revised return, in Form ST-3, in triplicate, to correct a mistake or omission, within a period of ninety days from the date of submission of the return under rule 7

Similar facility is also there for returns to be filed by assessee under CENVAT Credit Rules, 2004 [Rule 9(11) of CENVAT Credit Rules].

12.10.3 Penalty for late Filing of Return

If return of service tax is not filed within the prescribed period penalty is leviable under section 77(2) which can be upto ₹10,000.
Section 70(1) with effect from 11.5.2007 provides for late fee also. Accordingly, late fee is payable as follows: (Rule 7C of Service Tax Rules, 1994). If late fee is paid then no penalty shall be leviable.

<table>
<thead>
<tr>
<th>Delay upto 15 days</th>
<th>₹ 500/-</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delay upto 30 days</td>
<td>₹ 1,000/-</td>
</tr>
<tr>
<td>Delay beyond 30 days</td>
<td>₹ 1,000 + ₹ 100/- per day subject to a maximum of ₹ 2,0000/-</td>
</tr>
</tbody>
</table>

12.11 RECOVERY OF SERVICE TAX

Central Excise Officers have been empowered to demand duty, impose penalty and confiscate offending goods. They can also sanction refund claims. They are ‘adjudicating authorities’. These are ‘quasi juridical authorities’.

Central Excise Officers have been empowered to adjudicate in following:
— Demand of service tax and its recovery – Section 73.
— Rectification of mistake by amending its own order – Section 74.
— Imposition of penalty – Section 83A inserted w.e.f. 13 May 2005.
— Refund of service tax – Section 11B of Central Excise Act made applicable to Service Tax.

12.11.1 Recovery of service tax not levied or paid or short levied or short paid or erroneously refunded section 73(1):

(A) Time Limit for Issue of show cause notice

Where any service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded, the Central Excise Officer may, within one year from the relevant date, serve notice on the person chargeable with the service tax which has not been levied or paid or which has been short-levied or short-paid or the person to whom such tax refund has erroneously been made, requiring him to show cause why he should not pay the amount specified in the notice:

Provided that where any service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded by reason of —

(a) fraud; or
(b) collusion; or
(c) wilful mis-statement; or
(d) suppression of facts; or
(e) contravention of any of the provisions of this Chapter or of the rules made there under with intent to evade payment of service tax, by the person chargeable with the service tax or his agent, the provisions of this sub-section shall have effect, as if, for the words "one year", the words “five years” had been substituted.

(B) Relevant date for issue of show cause notice

Relevant date for calculating limit of one year/five year for issue of show cause
notice is as follows [Section 73(6)]:

(i) In the case of taxable service in respect of which service tax has not been levied or paid or has been short levied or short paid – (a) Where a periodic return is to be filed, the date on which such return was filed. (b) Where no return was filed, the last date on which the return should have been filed under Service Tax Rules. (c) In any other case, the date on which service tax is to be paid under provisions of Finance Act, 1994 or Service Tax Rules, 1994.

(ii) In case where service tax is provisionally assessed, the date of adjustment of service tax after final assessment thereof.

(iii) In case any sum relating to service tax, has been erroneously refunded, the date of such refund.

(C) Payment before receipt of show cause notice

Assessee may pay such tax on the basis of own ascertainment or on the basis of tax ascertained by Central Excise Officer, before issue of show cause notice. After payment of tax, assessee should inform the Central Excise Officer in writing about such payment, and then the central excise officer shall not issue any show cause notice under Section 73(1) in respect of service tax so paid [Section 73(3)].

However, even after such payment, show cause notice for further amount can be issued within one year from the date on which the assessee had informed the Central Excise Officer about payment of service tax by him [proviso to Section 73(3)].

Even after payment of tax by assessee, demand can be raised within five years in case of suppression of facts, fraud, collusion, willful misstatement or contravention of any provision with intent to evade service tax [Section 73(4)].

No show cause notice shall be issued where the person chargeable to tax pay the service tax along with interest and penalty equal to 1% per month for the period during which default continues maximum to 25% of the tax amount where during the course of audit, investigation or verification it is found that any service tax has not been levied or paid or has been short-paid or erroneously refunded.

12.12 PROVISIONAL ATTACHMENT PENDING ADJUDICATION

Finance Act, 2006 has added a provision for provisional attachment of property of a person to whom show cause notice has been serviced under Sections 73 or 73A, if the Central Excise Officer is of the opinion that it is necessary to do so, to protect interests of revenue. He can do so only with previous approval of Commissioner of Central Excise [Section 73C(1) inserted w.e.f. 18.4.2006].

The provision seems to be harsh and may lead to harassment of assesseees, though some safeguards have been kept.

The attachment can be done only in a manner prescribed by rules and only with previous written approval of Commissioner.

The attachment will cease to have effect after six months from date of order of attachment [Section 73C(2)]. This period can be extended with written permission of
Chief Commissioner of Central Excise, but total period of extension cannot be for more than two years.

**12.13 AMOUNT COLLECTED REPRESENTING AS SERVICE TAX MUST BE PAID TO GOVERNMENT**

If a person liable to pay service tax collects from recipient of taxable service, an amount representing as service tax, in excess of service tax assessed or determined and paid on any taxable service, the excess amount must be deposited forthwith with Government [Section 73A(1) inserted w.e.f. 18.4.2006].

If a person collects from any person an amount representing it as service tax when not required to be collected, he shall forthwith deposit the amount so collected to Government [Section 73A(2) inserted w.e.f. 18.4.2006].

Thus, the provision applies even in cases where person collects an amount representing it as ‘service tax’, though the amount was not ‘required’ to be collected ‘Required’ means ‘required’ under any law.

**12.14 INTEREST ON DELAYED PAYMENT OF SERVICE TAX UNDER SECTION 75**

Every person, liable to pay the tax in accordance with the provisions of section 68 or rules made thereunder, who fails to credit the tax or any part thereof to the account of the Central Government within the period prescribed, shall pay simple interest at such rate not below 10% and not exceeding 36% p.a.

However where the service provider whose taxable services does not exceed ₹60 lakhs during any of the financial years covered by the notice or during the last financial year the rate of interest shall be reduced by 3% p.a.

**12.15 DOCTRINE OF UNJUST ENRICHMENT**

Since service tax is indirect tax, it is recoverable from customer. If you recover the amount from customer and again claim refund, you will get double benefit. Hence, provision of ‘unjust enrichment’ have been made in the law.

As per the doctrine of unjust enrichment, refund will be granted to assessee only if assessee had not passed on the tax burden to your customer/client. It will be presumed that assessee has passed on the burden of service tax. Thus, assessee will have to prove that he has not passed on the burden to your customer. If he is unable to prove it, refund will be paid to ‘Consumer Welfare Fund’ and not to assessee, as provided in Section 12C of Central Excise Act.

If assessee has shown the amount of service tax separately in invoice (which assessee is legally required to do), it will be difficult for assessee to establish that he has not passed on the tax burden to the client/customer.


If application for refund is rejected by AC/DC, appeal can be filed with Commissioner (Appeals).
12.16 PENALTIES

Various penalties have been provided under the Act. The penalties can be imposed by Central Excise Officers. There is no provision for prosecution under the Act.

(A) Penalty for failure to pay service tax [Section 76]

Any person who fails to pay service tax, shall pay, in addition to such tax and the interest on that tax amount in accordance with the provisions of section 75, a penalty which shall not be less than:

— one hundred rupees for every day during which such failure continues or
— at the rate of one per cent. of such tax, per month,

whichever is higher,

starting with the first day after the due date till the date of actual payment of the outstanding amount of service tax:

Provided that the total amount of the penalty payable in terms of this section shall not exceed 50% of the service tax payable.

Illustration

X, an assessee, fails to pay service tax of ₹ 10 lakhs payable by 5th March. X pays the amount on 15th March. The default has continued for 10 days. The penalty payable by X is computed as follows:-

— 1% of the amount of default for 10 days = 1 x 10, 00, 000 x 10/31 = ₹3,225.80

or

— Penalty calculated @ ₹ 100 per day for 10 days = ₹1,000

Penalty liable to be paid is ₹3,226.00.

(B) Penalty for contravention of rules and provisions of act for which no penalty is specified elsewhere [Section 77]

(a) Any person who is liable to pay service tax, or required to take registration, **fails to take registration** shall be liable to pay a penalty which may extend to:

— ten thousand rupees or
— two hundred rupees for every day during which such failure continues,

whichever is higher,

starting with the first day after the due date, till the date of actual compliance;

(b) Any person who fails to **keep, maintain or retain books of account and other documents** shall be liable to a penalty which may extend to:

ten thousand rupees;

(c) Any person who fails to—

(i) furnish information called by an
(ii) produce documents called for by a Central Excise Officer
(iii) appear before the Central Excise Officer, when issued with a summon
for appearance to give evidence or to produce a document in an inquiry,
shall be liable to a penalty which may extend to;
— ten thousand rupees or
— two hundred rupees for every day during which such failure continues,
whichever is higher,
starting with the first day after the due date, till the date of actual compliance;

(d) Any person who is required to pay tax electronically, through internet
banking, fails to pay the tax electronically, shall be liable to a penalty which
may extend to ten thousand rupees;

(e) Any person who issues invoice with incorrect or incomplete details or fails to
account for an invoice in his books of account, shall be liable to a penalty
which may extend to ten thousand rupees.

(2) Any person, who contravenes any of the provisions or any rules for which no
penalty is separately provided, shall be liable to a penalty which may extend to Ten
thousand rupees.”;

(C) Penalty for suppressing value of taxable service [Section 78]

Where any service tax has not been levied or paid or has been short-levied or
short-paid or erroneously refunded, by reason of
(a) fraud; or
(b) collusion; or
(c) wilful mis-statement; or
(d) suppression of facts; or
(e) contravention of any of the provisions or of the rules with intent to evade
payment of service tax,

the person shall be liable to pay service tax or erroneous refund, and also be
liable to pay a penalty, in addition to such service tax and interest which shall equal to
the amount of service tax so not levied or short-paid or erroneously refunded.

However the amount of penalty shall be reduced to:

(a) 50% where true and complete details of the transactions are available in the
specified records.
(b) 25% where true and complete details of the transactions are available in the
specified records and the amount of service tax, interest and penalty has
been paid within 30 days.

In case of service providers whose taxable value of service tax does not exceed
₹ 60 lakhs, the period of 30 days shall be extended to 90 days.
12.17 WAIVER OR REDUCTION OF PENALTY

As per Section 80, penalty under Sections 76, 77 or first proviso to section 78(1) can be waived if assessee proves that he had reasonable cause for the failure.

In *CCE v. Milan Tent Palace* 2001 (CEGAT), it was held that penalty is not mandatory and can be waived or reduced in deserving cases.

**Who can impose penalty**

Section 83A (inserted w.e.f. 13.5.2005) empowers Central Excise Officer to adjudicate penalty within such powers as may be conferred by CBEC, by issuing a notification.

12.18 ADVANCE RULING

“Advance ruling” means the determination, by the Authority, of a question of law or fact specified in the application regarding the liability to pay service tax in relation to a service proposed to be provided, by the applicant;

“applicant” means—

(i) (a) a non-resident setting up a joint venture in India in collaboration with a non-resident or a resident; or

(b) a resident setting up a joint venture in India in collaboration with a non-resident; or

(c) a wholly owned subsidiary Indian company, of which the holding company is a foreign company, who or which, as the case may be, proposes to undertake any business activity in India;

(ii) a joint venture in India or

(iii) a resident falling within any such class or category of persons, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

An applicant desirous of obtaining an advance ruling under this Chapter may make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought.

The question on which the advance ruling is sought shall be in respect of,-

(a) classification of any service as a taxable service under Chapter V;

(b) the valuation of taxable services for charging service tax;

(c) the principles to be adopted for the purposes of determination of value of the taxable service under the provisions of Chapter V;

(d) applicability of notifications issued under Chapter V;

(e) admissibility of credit of service tax.

(f) determination of the liability to pay service tax on a taxable service under the provisions of Chapter V.
The application shall be made in quadruplicate and be accompanied by a fee of two thousand five hundred rupees.

An applicant may withdraw an application within thirty days from the date of the application.

The authority is required to give its ruling within 90 days of the receipt of valid application.

An application may be rejected by the prescribed authority if the question or subject matter of ruling sought in the application is such which is already pending before any assessing officer, Tribunal and court of law or such question already stands decided by any court or bench of Tribunal.

The advance ruling pronounced by the Authority shall be binding only-
(a) on the applicant who had sought it;
(b) on the Commissioner of Central Excise, and the Central Excise authorities subordinate to him, in respect of the applicant.

The advance ruling shall be binding unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

No proceeding before, or pronouncement of advance ruling by, the Authority shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.

Test Your Knowledge

What is the fee for application for advance ruling?
(a) ₹ 500
(b) ₹ 1,000
(c) ₹ 1,500
(d) ₹ 2,500

Correct answer: d

12.19 CENVAT CREDIT RULES, 2004

The Finance Ministry has issued CENVAT Credit Rules following the budget decisions to extend credit of input taxes across goods and services from 10.09.2004. The Finance Act, 2004 has amended section 94 to provide that Central Government is empowered to make rules relating to inter-sectoral credit of service tax and excise duty. The move will facilitate integration of tax on goods and services (GST). The New CENVAT Credit Rules contain Rules for goods and services. Rules cover inputs, capital goods and services. One of the salient features of this rules is to make the rules simple and less cumbersome. The burden of proof regarding the adminisibility of CENVAT Credit is on the manufacturer or service provider who is availing credit. A new levy of education and higher secondary cess has been imposed subject to
CENVAT Credit and it shall be used only for the payment of such additional charge on output services/products. It is clear that the Central Government is trying to widen the tax bracket to include those services which till now is not brought under the tax provision. Earlier a threshold limit of four lakhs exemption is provided to the service provider and that limit was increased to ₹8 lakhs but from 1-04-2008 the exemption limit was increased to ₹10 lakhs. Cenvat credit of inputs and input services is not available if final product/output service is exempt from excise duty/service tax. In case of manufacturer manufacturing both exempt and dutiable goods (or service provider providing taxable as well as exempt services), it may happen that same inputs/input services are used partly for manufacture of dutiable goods/taxable services and partly for exempted goods/services.

In such cases, the manufacturer/service provider has following three options (w.e.f. 1.4.2011)—

(1) Maintain separate accout for inventory receipt, inputs and input services used for exempted goods/exempted output services and used for dutiable final products or for the provision of taxable output services.— (Rule 6(2) of Cenvat Credit Rules).

(2) Don’t Maintain Separate Account
   (a) Pay amount equal to 5% of value of exempted goods (if he is ‘manufacturer’) and/or 5% of value of exempted services (if he is service provider) if he does not maintain separate inventory and records – Rule 6(3)(i) w.e.f. 31.3.2011.
   (b) Pay an amount as determined in Sub-Rule (3A)
   (c) Maintain separate accounts for inputs and pay ‘amount’ as determined under Rule 6(3A) in respect of input services.

“Input Services”

Rule 2(l)(ii) of Cenvat Credit Rules, which defines ‘input service’ is amended w.e.f. 1.4.2011 as follows. “Input service” means any service—

(i) used by a provider of taxable service for providing an output service; or
(ii) used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal, and

Includes

services used in relation to modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, security, business exhibition, legal services, inward transportation of inputs or capital goods and outward transportation upto the place of removal;

but excludes services,—

(A) specified in sub-clauses (p), (zn), (zzl), (zzm), (zzq), (zzzh) and (zzzza) of
clause (105) of section 65 of the Finance Act (hereinafter referred as specified services), in so far as they are used for—

(a) construction of a building or a civil structure or a part thereof; or

(b) laying of foundation or making of structures for support of capital goods, except for the provision of one or more of the specified services; or

(B) specified in sub-clauses (d), (o), (zo) and (zzzzj) of clause (105) of section 65 of the Finance Act, in so far as they relate to a motor vehicle except when used for the provision of taxable services for which the credit on motor vehicle is available as capital goods; or

(C) such as those provided in relation to outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance and travel benefits extended to employees on vacation such as Leave or Home Travel Concession, when such services are used primarily for personal use or consumption of any employee;“;

Provisions of Cenvat Credit Rules relating to Service tax.

1. For a service provider the use of inputs and capital goods must be direct and they must be used for providing output service. Otherwise Cenvat Credit is not available on them.

2. Motor vehicles registered in the name of the service provider will be treated as capital goods for specified services such as outdoor catering, rent a cab, cargo handling, goods transport agency, tour operator & courier agencies.

3. Cenvat credit on service tax can be taken only when both service tax and service charge has been paid.

4. Service provider is not eligible take credit on special CVD paid on imported goods.

5. Service tax paid on input services by Input service distributor can be distributed among its constituent units.

6. In the budget 2008 service provider is allowed to transfer credit on inputs and capital goods to its other offices. For that registration under Central Excise is necessary.

7. A service provider has to reverse the Cenvat credit when he removes the inputs or capital goods as such.
   But no reversal is necessary if such inputs or capital goods are taken out for providing output service.

8. Cenvat credit on service tax can be taken on the strength of documents such as challan, Bill or invoice.

9. If the service provider uses inputs or input services both for exempted and taxable services, he should take credit proportionately by maintaining separate accounts. Otherwise he has to pay 5% on exempted services also.

12.20 APPEALS

Appeal can be filed against adjudication order as per following provisions.
If adjudication order is passed by authority lower than Commissioner of Central Excise, first appeal will be with Commissioner (Appeals) under Section 85(1) within three months from date of receipt of order of adjudicating authority.

Second and final appeal is with Appellate Tribunal (known as – Customs, Excise and Service Tax Appellate Tribunal – CESTAT) under Section 86(1). Appeal is required to be filed within three months.

If adjudication order is passed by Commissioner, appeal is to be filed to CESTAT under Section 86(1). The adjudicating order of Commissioner may be in respect of following – (a) Original adjudication of demand under Section 73, (b) Imposition of penalty under Section 83A, (c) Revision of order of lower authority under Section 84(1).

12.21 APPEALS TO THE COMMISSIONER OF CENTRAL EXCISE (APPEALS) [SECTION 85]

— Any person aggrieved by any decision or order passed by an adjudicating authority subordinate to the Commissioner of Central Excise may appeal to the Commissioner of Central Excise (Appeals).

— Every appeal shall be in the prescribed form and shall be verified in the prescribed manner.

— An appeal shall be presented within three months from the date of receipt of the decision or order of such adjudicating authority relating to service tax, interest or penalty.

Condonation of delay:

— The Commissioner of Central Excise (Appeals) may, if he is satisfied that the appellant was prevented by sufficient cause from presenting the appeal within the aforesaid period of three months, allow it to be presented within a further period of three months.

— The Commissioner of Central Excise (Appeals) shall hear and determine the appeals and, pass such orders as he thinks fit and such orders may include an order enhancing the service tax, interest or penalty.

Principle of Natural Justice:

— an order enhancing the service tax, interest or penalty shall not be made unless the person affected thereby has been given a reasonable opportunity of showing cause against such enhancement.

12.22 APPEAL TO TRIBUNAL (SECTION 86)

Any assessee aggrieved by an order passed by a Commissioner of Central Excise under section 73 or section 83A or section 84, or an order passed by a Commissioner of Central Excise (Appeals) under section 85, may appeal to the Appellate Tribunal against such order.

The Committee of Chief Commissioners of Central Excise may, if it objects to any order passed by the Commissioner of Central Excise under section 73 or section 83A or section 84, or by the Commissioner of Central Excise (Appeals) under section 85 direct the Commissioner of Central Excise to appeal to the Appellate Tribunal against
the order.

Every appeal shall be filed within three months of the date on which the order sought to be appealed against is received by the assessee, the Committee of Chief Commissioners.

The Commissioner of Central Excise or any Central Excise Officer subordinate to him or the assessee, notwithstanding that he may not have appealed against such order within forty-five days of the receipt of the notice, file a memorandum of cross-objections, verified in the prescribed manner.

The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the relevant period if it is satisfied that there was sufficient cause for not presenting it within that period.

Every application made before the Appellate Tribunal,
(a) in an appeal for grant of stay or for rectification of mistake or for any other purpose; or
(b) for restoration of an appeal or an application, shall be accompanied by a fee of five hundred rupees

Provided that no such fee shall be payable in the case of an application filed by the Commissioner of Central Excise or Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise.

12.23 CROSS OBJECTION SHOULD BE IN FORM ST-6 IN QUADRUPLE

Further appeals

Further appeals against order of Tribunal (CESTAT) lies with Supreme Court only in matters of valuation and classification. If there is substantial question of law (other than classification and valuation), appeal has to be filed with High Court. In case of matters relating to classification and valuation, appeal lies to the Supreme Court.

12.24 ROLE OF PRACTISING COMPANY SECRETARY

The educational background, knowledge, training and exposure that a Company Secretary has, makes him a versatile professional capable of rendering a wide range of services to companies of all sizes, other commercial and industrial organizations, small scale units, firms etc.

A Practising Company Secretary can render several services under the Service Tax such as:
— registration with tax authorities
— advising on applicability, rate and payment of service tax,
— filing of returns with the authorities,
— claiming exemption,
— advising on various procedural matters relating to service tax.

12.25 SERVICE TAX ON PRACTISING COMPANY SECRETARY
Regarding taxable services provided by Company Secretaries in Practice, the following is the position of the law:

As per Section 2(2) of Company Secretaries Act, 1980 a member of the Institute shall be deemed “to be in practice” when, individually or in partnership with one or more members of the Institute in practice or in partnership with members of such other recognized professions as may be prescribed, he, in consideration of remuneration received or to be received:

(a) engages himself in the practice of the profession of Company Secretaries to, or in relation to, any company; or

(b) offers to perform or performs services in relation to the promotion, forming, incorporation, amalgamation, reconstruction, recognition or winding up of companies; or

(c) offers to perform or performs such services as may be performed by—

(i) an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications and returns) by or on behalf of the company,

(ii) a share transfer agent,

(iii) an issue house,

(iv) a share and stock broker,

(v) a secretarial auditor or consultant,

(vi) an adviser to a company on management, including any legal or procedural matter falling under the Capital Issues (Control) Act, 1947 (29 of 1947), the Industries (Development and Regulation) Act, 1951 (65 of 1951), the Companies Act, the Securities Contracts (Regulation) Act, 1956 (42 of 1956), any of the rules or bye-laws made by a recognized stock exchange, the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969), the Foreign Exchange Regulation Act, 1973 (46 of 1973), or under any other law for the time being in force.

(vii) issuing certificates on behalf of, or for the purposes of, a company; or

(d) holds himself out to the public as a Company Secretary in practice; or

(e) renders professional services or assistance with respect to matters of principle or detail relating to the practice of the profession of Company Secretaries; or

(f) renders such other services as, in the opinion of the Council, are or may be rendered by a Company Secretary in practice;

and the words “to be in practice” with their grammatical variations and cognate expressions, shall be construed accordingly."

Notification No. 59/98-ST dated 16.10.1998: Prior to Notification 2/2006, certain services rendered by practicing company secretary were exempt by virtue of the Notification exempted the services provided *inter alia* by a Practising Company Secretary from service tax other than those services specifically listed in the said Notification.
This Notification was rescinded as a result of which all services provided by practicing company secretary have fallen within the ambit of levy of service tax.

The government has issued a Notification in 2006 exempting the taxable services provided or to be provided by a company secretary in his professional capacity to a client, relating to representing the client before any statutory authority in the cause of proceedings initiated under any law for the time being in force, by way of issue of notice. The text of Notification is reproduced below:

GOVERNMENT OF INDIA
MINISTRY OF FINANCE
(Department of Revenue)

Notification No. 25/2006-Service Tax
New Delhi, dated the 13th July, 2006
22 Asadha, 1928 (Saka)

G.S.R.418(E)—In exercise of the powers conferred by Sub-section (1) of Section 93 of the Finance Act 1994 (32 of 1994) hereinafter referred to as the Finance Act), the Central Government, on being satisfied that it is necessary in the public interest so to do, hereby exempts the taxable services falling under sub-clauses (s), (t) and (u) of clause (105) of Section 65 of the Finance Act, provided or to be provided by a practicing chartered accountant, a practicing cost accountant and a practicing Company Secretary respectively, in his professional capacity, to a client, relating to representing the client before any statutory authority in the course of proceedings initiated under any law for the time being in force, by way of issue of notice, from the whole of service tax leviable thereon under Section 66 of the said Finance Act.

(R. Sriram)
Deputy Secretary to the Government of India

The above notification rescinded by issue of Notification No. 32/2011 dt. 25/04/2011 as a result of which all services provided by practicing company secretaries are taxable.

ST : Chartered Accountants/Company Secretaries/Cost & Accountants – Exemption from service tax on taxable services provided by Practising Chartered Accountant, etc., - Recession of Notification No. 25/2006-ST, dated 13-7-2006

NOTIFICATION NO. 32/2011 – SERVICE TAX, DATED 25-4-2011

In exercise of the powers conferred by sub-section (1) of section 93 of the Finance Act, 1944 (32 of 1944), the Central Government, on being satisfied that it is necessary in the public interest so to do, hereby rescinds the notification of the Government of India in the Ministry of Finance (Department of Revenue) No. 25/2006 – Service Tax, dated the 13th July, 2006, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i) vide number G.S.R. 418(E), dated the 13th July, 2006, except as respects things done or omitted to be done before such rescission.

2. This notification shall come into force on the 1st day of May, 2011.
Services on which tax is imposed by Finance Act, 2011

(1) **Restaurants:** Services provided by air-conditioned restaurants having a license to serve alcoholic beverages in relation to serving of food and or beverages shall be included in the definition of taxable services.

(2) **Short-term accommodation:** Short term accommodation provided by a hotel, inn, guesthouse, club or campsite or any other similar establishment for a continuous period of less than three months shall be included in the definition of taxable services.

**Amendments made by Finance Act, 2010:**

Continuation of the policy of widening of the service tax base, the Finance Act, 2010 introduced eight other services.

Following services are specifically included in the list of taxable services:

1. Service of permitting commercial use or exploitation of any event organized by a person or organization.

2. The existing taxable service ‘Intellectual Property Right (IPR)’ excludes copyright from its scope. Copyrights on
   - cinematographic films and
   - sound recording are being brought under the ambit of service tax. However, copyright on original literary, dramatic, musical and artistic work would continue to remain outside the scope of service tax.

3. Service tax on the following health services:
   - health check up undertaken by hospitals or medical establishments for the employees of business entities; and
   - health services provided under health insurance schemes offered by insurance companies.
   (The tax on these health services would be payable only if the payment for such health check up or preventive care or treatment etc. is made directly by the business entity or the insurance company to the hospital or medical establishment).

4. Service provided for maintenance of medical records of employees of a business entity.

5. Service provided by Electricity Exchanges.

6. Certain additional services provided by a builder to the prospective buyers such as providing preferential location or external or internal development of complexes on extra charges. However, service of providing vehicle-parking space would not be subjected to tax.

7. Service of promoting of a ‘brand’ of goods, services, events, business entity etc.

8. The promotion, marketing or organizing of games of chance, including lottery, is being introduced as a separate service.

Following services are specifically included in the list of taxable services by Finance Act, 2009.
— Transport of goods by rail;
— Transport of coastal cargo and goods through inland water including National Waterways;
— Advisory, consultancy or technical assistance provided in the field of law will attract service tax however this tax would not be applicable in case the service provider or service receiver is an individual;
— Cosmetic and plastic surgery services.

**LESSON ROUND UP**

- The Chapter contains at the inception the procedures relating to levy collection and payment of service tax.
- Later on it covers the registration aspects relating to service tax.
- The chapter also contains substantive and procedural aspects regarding filing of returns including e-filing, refund and recovery of service tax and other related issues.
- Lastly the chapter contains the appeal provisions including appeal before Appellate Tribunal under relevant jurisdiction.

**SELF TEST QUESTIONS**

1. Discuss the procedures relating to collection and payment of service tax in India.
2. Explain briefly the registration procedures for the service tax of taxable services.
3. Explain briefly the procedural aspects of filing of returns including e-filing for service tax.
4. Discuss in brief the appeal procedures under the service tax regime.
5. Discuss briefly advance ruling applicable to taxable services under service tax.
The Committee of Finance Minister (in 1995 and 1998) have put forward recommendations to replace sales tax by Value Added Tax (VAT). Further the conference of Chief Minister and the Finance Minister has proposed introduction of VAT by April 1, 2002 with uniform floor rates. The Empowered Committee of State Finance Ministers on February 8, 2003 again endorsed the suggestion that all the State legislations on VAT should have a certain minimum set of common features. Most of the States came out with their respective draft legislations. Shri Jaswant Singh, the then Union Finance Minister, also announced the introduction of VAT from 1st April, 2003 in his 2003-2004 budget speech made on February 28, 2003. Owing to some unavoidable circumstances, VAT could not be implemented w.e.f. April 1, 2003 and also on the revised date June 1, 2003. Despite all obstacles, Haryana was the first State to implement VAT w.e.f. April 1, 2003. In rest of the States VAT Laws were at draft stage.

The Empowered Committee of the State Finance Ministers constituted by the Ministry of Finance, Government of India, on the basis of the resolution adopted in the conference of the Chief Ministers on November 16, 1999 under the Chairmanship of Dr. Asim Dasgupta came out with a White Paper on State-Level VAT, which was released on January 17, 2005 by Shri P. Chidambaram, The Finance Minister, Government of India.

13.1 INTRODUCTION

The Value Added Tax (VAT) in India is a state level multi-point tax on value addition which is collected at different stages of sale with a provision for set-off for tax
paid at the previous stage i.e., tax paid on inputs. It is to be levied as a proportion of
the value added (i.e. sales minus purchase) which is equivalent to wages plus
interest, other costs and profits. It is a tax on the value added and can be aptly
defined as one of the ideal forms of consumption taxation since the value added by a
firm represents the difference between its receipts and cost of purchased inputs.
Value Added Tax is commonly referred to as a method of taxation whereby the tax is
levied on the value added at each stage of the production/distribution chain. As
against the existing regime under which goods are charged to tax at Single point, or
multi-point on the value of the goods, without any credit being given for taxes paid at
the preceding stages. VAT intends to tax only the value added at each stage and not
the entire invoice value of the product. By ensuring that only the incremental value is
taxed, VAT aims at eliminating the cascading effect of taxes on commodities, and
thereby reduces the eventual cost to the consumer.

It is one of the most radical reforms, albeit only in the sphere of State level taxes
on sale, those have been initiated for the Indian economy after years of political and
economic debate aiming at replacing complicated tax structure to do away with the
fraudulent practices.

With the objective to introduce State-Level VAT in India in the Year 1992, the
Government of India constituted a Tax Reform Committee headed by Dr. Raja J.
Chelliah. In 1993, the Committee recommended the introduction of VAT in place of
existing tax system. Thereafter, the Government appointed NIPFP (National Institute
of Public Finance and Policy), New Delhi, as the Nodal Agency to work out the
modalities of VAT.

The first preliminary discussion on State-Level VAT took place in a meeting of
Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister
in 1995. In this meeting, the basic issues on VAT were discussed in general terms
and this was followed up by periodic interactions of State Finance Ministers.

For implementing the above decisions, an Empowered Committee of State
Finance Ministers was set-up. Thereafter, this Empowered Committee met frequently
and got full support from the State Finance Ministers, the Finance Secretaries and
the Commissioners of Commercial Taxes of the State Governments as well as Senior
Officials of the Revenue Department of the Ministry of Finance, Government of India.
Through repeated discussions and collective efforts of all, it was possible to achieve
remarkable success within a period of about one and half years. After reaching this
stage, steps were initiated for the systematic preparation for the introduction of State-
Level VAT.

Along with these measures ensuring convergence on the basis issues on VAT,
steps were taken for necessary training, computerization and interaction with trade
and industry, particularly at the State level. This interaction with trade and industry
was specially emphasized. The conference of State Chief Ministers presided over by
Shri Atal Behari Vajpayee, the then Prime Minister, held on October 18, 2002 at
which Shri Jaswant Singh, the then Finance Minister was also present, confirmed the
final decision that all the States and the Union Territories would introduce VAT from
April 1, 2003.

A White Paper on State-Level Value Added Tax (VAT) by The Empowered
Committee of State Finance Ministers (Constituted by the Ministry of Finance,
Government of India on the basis of Resolution Adopted in the Conference of the Chief Ministers on November, 16, 1999, New Delhi, January 17, 2005. The Empowered Committee in the White Paper has justified the introduction of VAT in the following words:

"In the existing sales tax structure, there are problems of double taxation of commodities and multiplicity of taxes, resulting in a cascading tax burden. For instance, in the existing structure, before a commodity is produced, inputs are first taxed, and then after the commodity is produced with input tax load, output is taxed again. This causes an unfair double taxation with cascading effects. In the VAT, a set-off is given for input tax as well as tax paid on previous purchases. In the prevailing sales tax structure, there is in several states also a multiplicity of taxes, such as turnover tax, surcharge on sales tax, additional surcharge, etc. With introduction of VAT, these other taxes will be abolished. In addition, Central Sales Tax is also going to be phased out. As a result, overall tax burden will be rationalized, and prices in general will also fall. Moreover, VAT will replace the existing system of inspection by a system of built-in self-assessment by the dealers and auditing. The tax structure will become simple and more transparent. That will improve tax compliance and also augment revenue growth. The VAT will therefore help common people, traders, industrialists and also the Government. It is indeed a move towards more efficiency, equal competition and fairness in the taxation system.

The first preliminary discussion on state-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of States Finance Ministers. Thereafter, in a significant meeting of all Chief Ministers, convened on November 16, 1999 by Shri Yashwant Sinha, the then Union Finance Minister, three important decisions were taken. First, before the introduction of State-level VAT, the unhealthy sales tax rate "war" among the States would have to end and sales tax rates would need to be harmonized by implementing uniform floor rates of sales tax for different categories of commodities with effect from January 1, 2000. Second, in the interest again of harmonization of incidence of sales tax, the sales-tax-related industrial incentive schemes would also have to be discontinued with effect from January 1, 2000. Third, on the basis of achievement of the first two objectives steps would be taken by the states for introduction of State-level VAT after adequate preparation. For implementing these decisions, an Empowered Committee of State Finance Ministers was set-up.

Thereafter, this Empowered Committee has met regularly, attended by the state Finance Ministers, and also by the Finance Secretaries and the Commissioners of Commercial Taxes of the State Governments as well as senior officials of the Revenue Department of the Ministry of Finance, Government of India. Through repeated discussions and collective efforts in the Empowered Committee, it was possible within a period of about a year and a half to achieve nearly 98 per cent success in the first two objectives on harmonization of sales tax structure through implementation of uniform floor rates of sales tax and discontinuation of sales-tax related incentive schemes. As a part of regular monitoring, whenever any deviation is reported from the uniform floor rates of sales tax, or from decision on incentives, the Empowered Committee takes up the matter with the concerned state and also the Government of India for necessary rectification.
Test Your Knowledge

Which of the following agency was appointed as the Nodal Agency to work out the modalities of VAT?

(a) National Institute of Public Finance and Policy
(b) National Institute of Finance
(c) Institute of Financial Planning
(d) Finance Ministry

Correct answer: (a)

The Committee of Finance Minister (in 1995 and 1998) have put forward recommendations to replace sales tax by Value Added Tax (VAT). Further the conference of Chief Minister and the Finance Minister has proposed introduction of VAT by April 1, 2002 with uniform floor rates. The Empowered Committee of State Finance Ministers on February 8, 2003 again endorsed the suggestion that all the State legislations on VAT should have a certain minimum set of common features. Most of the States came out with their respective draft legislations. Shri Jaswant Singh the then Union Finance Minister, also announced the introduction of VAT from 1st April, 2003 in his 2003-2004 budget speech made on February 28, 2003. Owing to some unavoidable circumstances, VAT could not be implemented w.e.f. April 1, 2003 and also on the revised date June 1, 2003. Despite all obstacles, Haryana was the first State to implement VAT w.e.f. April 1, 2003. In rest of the States VAT Laws were at draft stage.

White Paper

The Empowered Committee of the State Finance Ministers constituted by the Ministry of Finance, Government of India, on the basis of the resolution adopted in the conference of the Chief Ministers on November 16, 1999 under the Chairmanship of Dr. Asim Dasgupta came out with a White Paper on State-Level VAT, which was released on January 17, 2005 by Shri P. Chidambaram, The Finance Minister, Government of India. On this occasion the Finance Minister remarked:

“This is the first document which has been collectively prepared and put out to the people of the country by the Finance Ministers of all States…. We have formed the rainbow coalition to undertake one of the biggest tax reforms.”

This Paper consists of three parts. In Part I, justification of VAT and the background has been mentioned. In Part II, main Design of VAT as evolved on the basis of consensus among the States through repeated discussions in the Empowered Committee has been elaborated. In Part III, other related issues for effective implementation of VAT have been discussed.

The White Paper specified that registration under the VAT Act shall not be compulsory for the small dealers with gross annual turnover not exceeding ₹5 lakh. However, the Empowered Committee of State Finance Ministers has subsequently allowed the States to increase the threshold limit for the small dealers to ₹10 lakh, but the concerned State shall have to bear the revenue loss, on account of increase in
the limit beyond ₹5 lakh. The VAT Acts are designed so that high value taxpayers should not be spared and on the contrary small dealers should be hassle free from compliance procedures.

The objective of all such composition schemes is not to burden small dealers by the provisions of record keeping. Therefore, such schemes will generally contain the following features:

(i) small amount of tax shall be payable;
(ii) there shall be no requirement to calculate taxable turnover;
(iii) a simple return form to cover longer return period shall be sufficient.

All sales or purchases of goods made within the State except the exempted goods would be subjected to VAT as a consumption tax.

In his speech introducing Union Budget 2005-06, the Hon’ble Finance Minister said, “In a remarkable display of the spirit of cooperative federalism, the States are poised to undertake the most important tax reform ever attempted in this country. All States have agreed to introduce the Value Added Tax (VAT) with effect from April 1, 2005. VAT is a modern, simple and transparent tax system that will replace the existing sales tax and eliminate the cascading effect of sales tax.

In the medium to long term, it is my goal that the entire production/distribution chain should be covered by a national VAT, or even better, a goods and services tax, encompassing both the Centre and the States.

The Empowered Committee of the State Finance Ministers, with the solid support of the Chief Ministers, has laboured through the last seven years to arrive at a framework acceptable to all States. The Central Government has promised its full support and has also agreed to compensate the States, according to an agreed formula, in the event of any revenue loss. I take this opportunity to pay tribute to the Empowered Committee, and wish the States success on the introduction and implementation of VAT”.

Test Your Knowledge

Which of the following was the first State to implement VAT w.e.f. April 1, 2003?

(a) Maharashtra
(b) Punjab
(c) Haryana
(d) Karnataka

Correct answer: (c)

13.2 EXTRACTS FROM KELKAR COMMITTEE REPORT

Considering that the implementation of VAT was closely linked to the administration of other indirect taxes and impacts the tax to GDP ratio, it had become
necessary to examine the relevant issues. In this direction the Task Force has had the benefit of meeting with the Empowered Committee of the Finance Ministers of the States, constituted for the purpose of implementing a nationwide State-level VAT. The Empowered Committee experimented on federal fiscal planning and achieved much in terms of building a consensus on many of the critical issues relating to implementation of VAT in a relatively short spell of time. Most countries have taken several years to implement VAT. Decisions were taken on the important features of VAT relating to replacement of the State Tax levied by the States though some other local taxes like octroi, mandi, cess etc. may continue.

It was recommended that a publicity awareness programme shall be started jointly by the Central Government and the State Governments. The Central Government shall extend financial support for this, if needed. Since the State VAT is expected to be implemented from 1.4.2003, it is also necessary that the publicity awareness programme should be implemented at the earliest.

One of the issues which had impact on the transition of VAT was the compensation to be given to the States upon the removal of Sales tax and the introduction of State VAT, in the event the tax revenue drops due to the change over. In this regard it had been observed that the experience worldwide has been that a move towards VAT results in higher revenue realization.

During the meetings that the Task Force had with several industry and trade bodies, it was represented that the switch-over to VAT must ensure that the desired benefits are achieved, especially in view of the fact that this switch-over shall entail a major overhaul of systems and procedures for business and governments and at substantial expenditure of money, time and effort.

Under the existing sales-tax structure, there are problems of double taxation of commodities and multiplicity of taxes resulting in a cascading tax burden. As per the existing structure before a commodity is produced, inputs are first taxed and then after the commodity is produced with input tax load, output is taxed again. This causes an unfair double taxable with cascading effects. In the VAT, a set-off is given for input tax as well as tax paid on previous purchases.

The design of State-level VAT has been worked out by the Empowered Committee through several rounds of discussions and striking a federal balance between the common points of convergence regarding VAT and flexibility for the local characteristics of the States.

13.3 VAT LIABILITY

The Value Added Tax (VAT) is based on the value addition to the goods and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period (say, a month).

The White Paper specifies that registration under the VAT Act is not compulsory for the small dealers with gross annual turnover not exceeding ₹5 lakh. However, the Empowered Committee of State Finance Ministers has subsequently allowed the States to increase the threshold limit for the small dealers to ₹10 lakh, but the concerned States will have to bear the revenue loss on account of increase in the limit beyond ₹5 lakh.
VAT is so designed that high value taxpayers are not spared and on the contrary small dealers are also hassle free from compliance procedures.

**13.4 ADVANTAGES**

Various advantages of introducing VAT:
- to encourage and result in a better-administered system;
- to eliminate avenues of tax evasion;
- to avoid under valuation at all stages of production and distribution;
- to claim credit on tax paid on inputs at each stage of value addition;
- do away with cascading effect resulting in non distortion of the business decisions;
- permits easy and effective targeting of tax rates as a result of which the exports can be zero-rated;
- ensures better tax compliance by generating a trail of invoices that supports effective audit and enforcement strategies;
- contribution to fiscal consolidation for the country. As a steady source of revenue, it shall reduce the debt burden in due course;
- to help our country to integrate better in the WTO regime;
- to stop the unhealthy tax-rate war and trade diversion among the States, which had adversely affected the interests of all the States in the past.

**13.5 WORK CONTRACT TAX**

Some contracts are contracts for labour, work or service and not for sale of goods, though goods are in use in executing the contract for labour, work or service e.g., when a contractor constructs a building, the buyer pays for cost of building material labour and other services offered by the contractor. Property in the building is passed on to the buyer and there is no contract for supply of building material as such.

It is quite difficult to establish whether particular contract is 'contract for work' or contract of sale. For this any rigid test is not possible. It depends upon the main object of the parties, circumstances and custom of trade. Generally a contract of sale is a contract whose main object is to transfer of property in and delivery and possession of a chattel as a chattel to the buyer. In the case *Vanguard Rolling Shuttles v. CST* AIR 1977 CS 1505, the supreme has observed that it is very difficult to lay down any universal technique to determine what is contract of sale or what is job contract. In a recent case *ACC Limited v. CC* AIR 2001 SC 862. The Supreme Court held that even if the dominant intention of the contract is rendering of service which will amount to a works contract after 46th Amendment to the Constitution. The State would now be empowered to levy sale tax on material used in such contract.

In the case *Cooch Bihar Contractors Association v. State of West Bengal* (1996) 103 STC 477 (SC), it was held by the Hon'ble Court if contractor has to pay royalty and property gets transferred to him, it can be included for the purpose of work contract Act.
Many High courts have held that C Form can be issued for purchase of goods which are used in works contract. The dealer is entitled to registration and he can receive sales tax forms in respect of his sales.

Central Sales Tax will be payable on goods involved in works contract if goods moved from one state to another on account of such works contract from 11.5.2002 onwards.

There can certainly be inter-state works contract in case of movable property e.g., printing contracts. In fact CST can be levied on any goods involved in works contract in case of movable property.

Test Your Knowledge
What are some of the advantages of introducing VAT?
(a) Encouraging and resulting in a better-administered system
(b) Avoiding under valuation at all stages of production and distribution
(c) Retaining cascading effect resulting in non-distortion of the business decisions
(d) Claiming credit on tax paid on inputs at each stage of value addition

Correct answer: (a), (b) and (d)

13.6 WITHDRAWAL OF CENTRAL SALES TAXES
Presently, CST will continue, though it is proposed to be phased out in due course. The provisions in respect of Central Tax are summarized below:

(i) CST may go after decision in respect of loss of revenue to States is taken and comprehensive Taxation information System is put in place [Para 4.3 of White Paper on State-Level VAT]. Note that CST has been reduced to 3% w.e.f. 1.4.2007, and further reduced to 2% w.e.f. 1.6.08.

(ii) Present forms i.e., C, D, E-I/E-II and H will also continue, D form has been abolished w.e.f. 1.4.2007.

(iii) There will be no credit of CST paid on inter-state purchases [Para 2.6 of White Paper on State-Level VAT]

(iv) If goods are sent on stock transfer outside the State, input tax paid in excess of 2% will be allowed as credit. In other words, input tax to the extent of 2% will not be allowed as credit if goods are sent inter-state.

13.7 GOODS AND SERVICE TAX
Conceptually although not presently so in India, VAT covers both tax on sale of goods and tax on services. In few countries such as, Singapore, Canada etc., it is known as Goods and Service Tax. The Task Force headed by Dr. Vijay Kelkar had
also recommended a comprehensive goods and services tax. Goods & Service Tax (GST) is expected to be implemented with effect from 1.4.2012.

LESSON ROUND UP

- This chapter covers the legislative background and introduction of VAT including the white paper on the same subject matter.
- Chapter also contains elaborately the decisions of the Empowered Committee of the State Finance Ministers under the Chairmanship of Dr. Ashim Kumar Dasgupta deliberating on this issue.
- The Chapter also discussed the matters relating to Works Contract Act, withdrawal of Central Sales Tax and GST.

SELF TEST QUESTIONS

1. Discuss briefly the legislative background and the role of the empowered committee in implementing VAT in our Country.
2. Explain in brief the legal as well as tax implications to works contract.
3. Write a short note on “Goods and Service Tax”.
4. Enumerate selected points regarding withdrawal of CST by 2010.
STUDY XIV
COMPUTATION AND OTHER PROCEDURAL ASPECTS RELATING TO VAT

In this Chapter computation, registration, filing of returns and other relevant matters relating to VAT has been dealt. Issues relating to refunds, audit and appeal procedures is also incorporated in this chapter. In a nutshell, this chapter caters to the need of practically explaining the intricacies of VAT regime in general.

LEARNING OBJECTIVES

This chapter covers the following topics:
- Methods of Computation
- Procedure
- Rates of Tax
- Distinction between Existing System and VAT
- Registration
- Exempt Sale
- Credit and Set-off under VAT
- Assessment
- Audit
- Returns
- Zero Rating
- Refunds
- Audit
- Appeals, Revision and Appearances

14.1 METHODS OF COMPUTATION

VAT can be computed by using any of the three methods detailed below:

1. The Subtraction method: Under this method the tax rate is applied to the difference between the value of output and the cost of input;

2. The Addition method: Under this method value added is computed by adding all the payments that are payable to the factors of production (viz., wages, salaries, interest payments, etc.);
3. **Tax Credit method:** Under this method, it entails set-off of the tax paid on inputs from tax collected on sales. Indian States opted for tax credit method, which is similar to CENVAT.

14.2 PROCEDURE

The VAT is based on the value addition to the goods and the related VAT liability of the dealer is calculated by:

- Deducting input tax credit from tax collected on sales during the payment period.
- This input tax credit is given for both manufacturers and traders for purchase of input/supplies meant for both sales within the State as well as to the other States irrespective of their date of utilization or sale.
- If the tax credit exceeds the tax payable on sales in a month, the excess credit will be carried over to the end of the next financial year.
- If there is any excess unadjusted input tax credit at the end of the second year then the same will be eligible for refund.
- For all exports made out of the country, tax paid within the State will be refunded in full.
- Tax paid on inputs procured from other States through inter-State sale and stock transfer shall not be eligible for credit.

VAT has been introduced by 30 States / UTs. However, Central Sales Tax will continue to govern inter-State Sales and Exports.

**Test Your Knowledge**

Under which method is the rate of tax applied to the difference between the value of output and the cost of input?

(a) Subtraction method  
(b) Addition method  
(c) Tax Credit method  
(d) None of the above

*Correct answer : (a)*

14.3 RATES OF TAX

Four Types of VAT Rates: As contrasted to the multiplicity of rates under the existing regime, VAT will have 4 broad rates.

- 0% (Exempted) for unprocessed agricultural goods, and goods of social importance), 1% for precious and semiprecious metals,  
- 4% for inputs used for manufacturing and on declared goods, capital goods and other essential items,  
- 20% for demerit/luxury goods and
— the rest of the commodities will be taxed at a Revenue Neutral Rate of 12.5%.

14.4 DISTINCTION BETWEEN EXISTING SYSTEM AND VAT

<table>
<thead>
<tr>
<th>Existing System:</th>
<th>VAT System:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Earlier the local sales tax was based on single point tax. The single point tax was either at first point or at last point. The First point tax (FPT) was convenient to the revenue but had inbuilt cascading effect. The Last Point Tax (LPT) is an ideal system but it was evasion prone. Creates loss of revenue to the government.</td>
<td>The VAT system on the other hand reduces the disadvantages of both FPT and LPT and at the same time draws the advantages from both. The VAT system obviously is more transparent, uniform and less prone to tax evasion.</td>
</tr>
<tr>
<td>2. States continue to tax declared goods on single point basis under the existing system subject to a rate of 4%.</td>
<td>Under VAT, declared goods will also suffer tax at multiple levels</td>
</tr>
<tr>
<td>3. Under the existing Sales tax systems, inputs used for manufacture, whether capital or otherwise, are eligible for concessional rate of tax on furnishing the requisite forms.</td>
<td>However, under the VAT system, there is no place for concessions. Goods will be taxed at their respective rates, of course, with a provision for set off in future. There will be no incentive schemes under VAT, barring those carried forward from the existing system.</td>
</tr>
<tr>
<td>4. The exports are exempt from tax and supplies to exporters i.e. penultimate sales are also exempt subject to certain conditions.</td>
<td>Under VAT, exports are zero rated i.e. they are not exempted, giving rise to refund of tax paid on inputs.</td>
</tr>
<tr>
<td>5. There is no set off of prior taxes paid under the existing system of Single Point Tax and Multi-point tax.</td>
<td>In the VAT system, all prior taxes are given setoff against output tax if the sale is not an exempt sale.</td>
</tr>
</tbody>
</table>

The following illustration may show the difference between first point tax and last point tax.

Assume the base price of the commodity is ₹1000 and the government wishes to collect sales tax of 10% on base price i.e. ₹100.

**Taxation**

<table>
<thead>
<tr>
<th>F.P.T.</th>
<th>₹</th>
<th>L.P.T.</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price paid by A</td>
<td>1,000</td>
<td>Price paid by A</td>
<td>1,000</td>
</tr>
<tr>
<td>Tax paid by A</td>
<td>100</td>
<td>Tax paid by A</td>
<td>Nil</td>
</tr>
<tr>
<td>Total</td>
<td>1,100</td>
<td>Total</td>
<td>1,000</td>
</tr>
<tr>
<td>Margin @50% added by A</td>
<td>550</td>
<td>Margin added by A @50%</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td>Price paid by B</td>
<td>Margin @50% added by B</td>
<td>Price paid by B</td>
</tr>
<tr>
<td>----------------------</td>
<td>-----------------</td>
<td>------------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td></td>
<td>1,650</td>
<td>825</td>
<td>1,500</td>
</tr>
<tr>
<td></td>
<td>2,475</td>
<td>2,250</td>
<td>2,475</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td><strong>Price paid by Consumer</strong></td>
<td>2,475</td>
<td></td>
<td><strong>Price paid by Consumer</strong></td>
</tr>
</tbody>
</table>

In both the cases as above, the tax collected by the government is ₹ 100 but consumer would pay more under F.P.T. than under L.P.T. Under VAT, the consumer would pay the same amount as under F.P.T. but the government would get the tax of ₹ 125/- instead of ₹ 100/-.

**VAT Regime**

— The rates shall be uniform. However, it is possible that items under the exempted category and 4% category may be broadly similar across all States.

— Each State has its own VAT Act, Rules, Schedules, and Forms. therefore there will remain differences even in definitions among various Acts.

— Petroleum products, like Aviation Turbine Fuel, Naphtha, etc. used as fuel for running automobiles are brought under VAT, but credit cannot be taken on the tax paid thereon.

— Tobacco, Textiles and Sugar, which were under additional duty in lieu of excise and not under State taxation, are brought into the State Tax net at a rate not more than 4%, thereby integrating these products in the VAT structure.

**Test Your Knowledge**

What is the rate of VAT for precious and semiprecious metals?

(a) 0%
(b) 3%
(c) 4%
(d) 1%

*Correct answer: (d)*

14.5 REGISTRATION

Every dealer up to the retailer level is required to be registered with the Sales Tax department to avail the credit of input tax. However, there would be a threshold turnover level. The retailers with turnover below the threshold can opt not to register, but pay a nominal composition tax. However, such dealers are not entitled to take credit of prior stage tax, nor can they pass the credit to their buyers. In effect, the VAT chain breaks at their stage. Those opting not to register under VAT can opt for general registration.
Registration of dealers with gross annual turnover above the threshold limit will be compulsory. There will be provision for voluntary registration for dealers with gross annual turnover of less than the threshold limit. All existing dealers will be automatically registered under the VAT Act. A new dealer will be allowed 30 days time from the date of his being liable to get registered.

**Scheme of VAT Payment:**

Small dealers with gross annual turnover not exceeding the threshold limit will not be liable to pay VAT. States will have flexibility to fix threshold limit within ₹10 lakh. Small dealers with annual gross turnover not exceeding ₹25 lakh who are otherwise liable to pay VAT, shall however have the option for a composition scheme with payment of tax at a small percentage of gross turnover. The dealers opting for this composition scheme will not be entitled to input tax credit.

This entire design of VAT with input tax credit is crucially based on documentation of tax invoice, cash memo or bill. Every registered dealer, having turnover of sales above an amount specified, shall issue to the purchaser [who is entitled to tax credit and not to the final consumer] serially numbered tax invoice with the prescribed particulars. This tax invoice will be signed and dated by the dealer or his regular employee, showing the required particulars.

**14.6 EXEMPTED SALE**

When a certain sale is exempted from tax, the dealer effecting the exempt sale will not be entitled to any VAT credit on the inputs purchased by him. The sale effected by him will also be exempt from any tax. This results in breaking of the VAT chain.

**Samples or Gifts:**

Another example where reversal will be required is when goods are sold as samples or gifts i.e., non-taxable transactions and the input tax credit relating thereto has already been availed against output tax payable on other sale transactions. In such circumstances, the credit earned will be reversed. This is called “Reverse Credit of Input Tax”.

**Consignment transfer:**

Stock/Consignment transfers are exempt from VAT as these were never under the purview of the State Tax Acts. The input tax paid on such commodities or on the inputs that go into producing such commodities can be taken credit to the extent of excess of input tax over and above 4%. Thus, if the input used in the commodity that is transferred, or the product itself when purchased, was taxed at say 10%, credit can be taken by the transferring dealer to the extent of 6% against other taxable dispatches.

Imported goods will continue to be exempt from VAT on imports. Under VAT, there is no place for Entry taxes and Octroi.

**14.7 CREDIT AND SET-OFF UNDER VAT**

VAT aims at providing set-off for the tax paid earlier and this is given effect
through the concept of input tax credit.

**Input tax credit** in relation to any period means setting the amount of input tax by a registered dealer against the amount of his output tax.

Tax paid on the earlier point is termed as, “input tax”. This amount is adjusted against the tax payable by the purchasing dealer on his sales. This credit availability is called input tax credit.

**Input tax** is the tax paid or payable in the course of business on purchase of any goods made from a registered dealer of the State.

**Output tax** means the tax charged or chargeable under the Act, by a registered dealer for the sale of goods in the course of business.

![In simple words, input tax is the tax a dealer pays on his local purchases of business inputs which include raw materials, capital goods as well as other inputs used directly or indirectly in his business. Output tax is the tax that a dealer charges on his sales that are subject to tax.](image)

The input tax credit is to be given for both manufacturers and traders for purchase of inputs/ supplies meant for both sale within the State as well as to other States, irrespective of when these were utilized or sold. This also reduces immediate tax liability.

Input tax paid in excess of 2% on stock transfers to other states will be eligible for tax credit. It is also to be noted that in certain cases, partial input tax credit is available in respect of input used for manufacture of exempted goods.

Input tax credit is allowable to a registered dealer for purchase of any goods made within the State from a dealer holding a valid certificate of registration under the Act. Input tax credit on capital goods is available for traders and manufacturers.

**No input credit on CST paid on purchases from other states:** Central sales tax paid on inter-state purchases is not eligible for being set off against Value Added Tax payable in the state.

**Input tax on capital goods:** While taxes paid on raw materials and inputs are eligible for set off against taxes on output, taxes paid on capital goods are not eligible for immediate set-off. The reason perhaps is the huge credit that States may have to grant in cases of capital purchases of large value. Due to this, tax on capital goods may be granted, but over a certain period of time.

**Input tax in case of export sales:** Export sales are zero rated and thereby exporters are either granted refund of input taxes paid by them or they can adjust such input tax while making domestic sales.

In some cases, the input tax paid and taken credit of, may have to be reversed as such, for example, when the material is consumed for personal purposes and not for business purposes, or when the input including packing materials is used for manufacture and/or sale as exempt goods etc.

All tax-paid goods purchased on or after April 1, 2004 and still in stock as on April 1, 2005 will be eligible to receive input tax credit, subject to submission of requisite documents. Resellers holding tax-paid goods on April 1, 2005, and input tax credit
shall be given for the sales tax already paid in the previous year. This tax credit shall be available over a period of 6 months after an interval of three months needed for verification.

Test Your Knowledge

Which of the following tax is paid by the dealer on his/her local purchases of business inputs?

(a) Input tax  
(b) Output Tax  
(c) First Point Tax  
(d) Last Point Tax

Correct answer: (a)

14.8 ASSESSMENT

The VAT liability shall be self-assessed by the dealer himself. It pre-supposes that all the dealers act in honest manner. Scrutiny may be done in cases where there are doubts arising due to under reporting of transactions or evasion of tax.

14.9 AUDIT

There shall no longer be compulsory assessment at the end of each year. Correctness of self-assessment shall be checked through a system of Department Audit. A certain percentage of the dealers shall be taken up for audit every year on a scientific basis. In case of detection of evasions during the course of audits, the concerned dealer may be taken up for audit for previous periods. This Audit Wing shall remain delinked from tax collection wing to remove any bias. The audit team shall conduct its work in a time bound manner and audit shall be completed within six months and the audit report shall be transparently sent to the dealer as well.

Simultaneously, a cross-checking through computerized system shall be done on the basis of coordination between the tax authorities of the State Governments and the authorities of Central Excise to compare constantly the tax returns and set-off documents of VAT system of the States and those of Central Excise. This comprehensive cross-checking system shall help reduction in tax evasions and also lead to significant growth of tax revenue.

14.10 RETURNS

The return filing procedures are designed in such a way that the compliance costs are minimum. A registered dealer shall be required to file a return along with the requisite details such as output tax liability, value of input tax credit, payment of VAT.

Under VAT there exist simple forms of returns, which shall be filed monthly or quarterly or annually as per the provisions of various State laws. Returns shall be accompanied with the challans evidencing payment of tax. In certain States, returns cum challan forms have been devised. In those cases, the returns along with the payment have to be filed with the treasury.
Every return so furnished is required to be scrutinized expeditiously within the prescribed time limit from the date of filing the return. If any technical mistake is detected on scrutinizing, the dealer shall be required to rectify the defect or pay the deficit respectively.

14.11 ZERO RATING

Zero Rating means that the tax payable on sale of a commodity is fixed at 0%. Though apparently, it looks similar to an exempted transaction, there is a significant difference between the two. While in an exempted transaction, the tax paid on input lapses i.e. it cannot be set off, under the Zero rated sales, prior stage tax is set off against the 0% tax paid, and effectively the entire tax paid on purchases is eligible for refund. Thus, ‘Zero Rating’ is advantageous to the dealer compared to ‘exempting’ of sale transactions. Generally, export sales are zero rated and thereby, exporters are granted refund of taxes paid by them on their inputs. Exporters gain significantly due to the ‘Zero Rating’.

14.12 REFUNDS

Refunds are to be granted by the end of the financial year. Thus, the benefit of zero rating is not immediate, but deferred. Some States have also provided for refund where the tax paid on inputs exceeds the output tax payable and cannot be set off in a given period. In such cases, the excess tax not so set off shall be refunded after adjusting any dues towards interest, penalty, etc., in accordance with the State VAT Act.

14.13 SCRUTINY PROCESS

The correctness of self assessment will be checked through a system of departmental audit. It is a sample audit by which a certain percentage of assessees or dealers are taken on scientific basis for audit purposes. If it is found that some of the dealers deliberately defalcated their dues for the particular Financial Year then the department will carry out audit of previous financial years. The audit wing is separated from the collection wing in order to ward off any kind of biasness. The entire audit process is conducted in a transparent way and such process should be completed within six months. The audit report should be provided to the dealer and other concerned persons. Simultaneously a cross checking computerized system is also being used in coordination with tax authorities of the State Governments and the authorities of Central Excise and Income Tax to compare the tax returns and set off documents of VAT system of the states and those of Central Excise and Income Tax. This comprehensive cross checking will help to reduce tax evasion and also lead to significant growth in tax base of the country.

14.14 APPEALS, REVISION AND APPEARANCES

As we know that in India there is no central Value Added Tax Act till now. The reason being sales tax is state subject found in List II of the Seventh Schedule of our Constitution. As a result the Central Government cannot used their preporgative to institute in a Central Act governing VAT in our country. There is no consensus among states to introduce a unique Act which will apply to all states and union territories without any reservation and constraints. The eventuality is being separate states have their own VAT Act an those states which do not have the relevant Act are in the process of making them. The States making those Acts is according to their own conveyance and likings which serves their interest more profoundly. Since different
states and union territories have their own VAT Act and Rules, the appeal, revision and other relevant issues are explained differently. As a result any representative provisions relating to appeals, revision and appearances cannot be stated. It is worth mentioning that some states have recognised till now company secretaries as authorised representative to represent their client’s case before any VAT authority. The states are West Bengal, Gujarat, Bihar, Goa and Karnataka. Other states are in the process of recognizing company secretaries as professionals who can appear before their respective VAT authorities.

**LESSON ROUND UP**

- Discuss briefly the methods of computing VAT.
- Explain briefly the procedure relating to registration under VAT system.
- Concepts like zero rating and exempt sale is explained in lucid manner to give the reader clarity on these concepts.
- Other related issues relating to procedural aspects is also discussed in this Chapter.

**SELF TEST QUESTIONS**

1. Write short notes on the following:
   (i) Exempted sale;
   (ii) Zero rating.
2. What is credit and set-off under the VAT System.
3. Explain the audit procedure applicable under the VAT system.
4. Explain in detail the registration procedures under the VAT system.
STUDY XV

APPONNEMENT, JURISDICTION AND POWERS OF AUTHORITIES
AND THE CERTIFICATIONS FOR PROFESSIONALS

This chapter covers the legislative provisions in different states relating to the appointment, jurisdiction and powers of the authorities.

LEARNING OBJECTIVES

This chapter covers the following topics:
- The VAT system
- Some of the states in which VAT is implemented:
  - Andhra Pradesh
  - Arunachal Pradesh
  - Bihar
  - Chattisgarh
  - Goa
  - Gujarat
  - Haryana
  - Himachal Pradesh
  - Karnataka
  - Kerala
  - Madhya Pradesh
  - Maharashtra
  - Orissa
  - Punjab
  - Tamilnadu
  - Uttar Pradesh
  - West Bengal
  - Certification for Professionals

15.1 THE VAT SYSTEM

The VAT system is increasingly applied by different states of our country as an alternative to the existing Sales Tax System. The Empowered Committee on VAT
under the Chairmanship of Dr. Ashim Kumar Dasgupta justified the implementation of VAT System in our country. The development of Vat System in our country is not according to the expectation of the Empowered Committee. 30 states and union territories, adopted the VAT regime. Initially there is some apprehension in some states of the danger of loosing revenue to other states, if VAT is implemented. As a result the development of VAT system has taken more time then it is reasonably required for. As we know the Central Sales Tax Act, 1956 would be phased out by 2010, it becomes imperative for our economy that the VAT system should be implemented all over the country.

15.2 SOME OF THE STATES IN WHICH VAT IS IMPLEMENTED

15.3 ANDHRA PRADESH

Appointment, jurisdiction and powers of the authority

Under section 3A of the Andhra Pradesh Value Added Tax Act, 2005 the state Government may appoint a Commissioner of Commercial Taxes and as many

— Commissioners of Commercial Taxes
— Joint Commissioners of Commercial Taxes
— Appellate Deputy Commissioners of Commercial Taxes
— Deputy Commissioners of Commercial Taxes
— Assistant Commissioners of Commercial Taxes
— Commercial Tax Officers and
— Deputy Commercial Tax Officers

for the purpose of performing the functions respectively conferred on them by or under the Act.

The State Government under Section 3 of the above Act shall appoint an Appellate Tribunal consisting of the Chairman and two other members. To exercise the functions conferred on the Appellate Tribunal by or under the Act. The Chairman shall be the judicial officer not below the rank of a District Judge super time scale/district judge selection grade and of the other two members, one shall be the Officer of the State Government not below the rank of a Joint Commissioner of Commercial Taxes.

Under Section 28 of the Act The Deputy Commissioner shall have the powers of a Collector under the Andhra Pradesh Revenue Recovery Act, 1864 for the purpose of recovery of any amount due under the Act.

Any Officer of the Commercial Tax Department under Section 63 of the Act has the power to summon witnesses and production of documents. It has also the power to gather information under any proceedings.
Test Your Knowledge

Under Section 28 of the Act the ____________ shall have the powers of a Collector under the Andhra Pradesh Revenue Recovery Act, 1864 for the purpose of recovery of any amount due under the Act.

(a) Deputy Commissioner
(b) Commercial Tax Officer
(c) Deputy Commercial Tax Officers
(d) Commissioners of Commercial Taxes

Correct answer: (a)

15.4 ARUNACHAL PRADESH

Appointment, jurisdiction and powers of the authority

Under section 67(2) to assist the Commissioner in the administration of this Act—

(a) the Government may appoint as many Additional Commissioners of Goods Tax as the government thinks necessary; and

(b) the Commissioner may engage and procure the engagement of other persons to assist him in the performance of his duties (in this Act referred to as “Goods Tax Authorities”).

(c) the Commissioner and the Goods Tax authorities shall exercise such powers as may be conferred, and perform such duties as may be required, by or under this act.

Under section 68(1) of the Arunachal Pradesh Value Added Tax Act the Commissioner shall have responsibility for the due and proper administration of the Act and shall have jurisdiction over the whole of Arunachal Pradesh.

Under section 69(1) the Commissioner may delegate any of his powers under this act to any Goods Tax authorities, except the power conferred by this section.

15.5 ASSAM

Appointment, jurisdiction and powers of the authority

Under section 3(2) of the Assam Value Added Tax, 2003, there shall be the following taxing authorities to assist the Commissioner:

— Additional Commissioner of Taxes
— Joint Commissioner of Taxes
— Deputy Commissioner of Taxes
— Assistant Commissioner of Taxes
— Superintendent of Taxes
— Inspector of Taxes.
The Commissioner shall perform his functions in respect of the whole of the state of Assam. The government may authorize an officer not below the rank of Deputy Commissioner of Taxes to exercise the power and perform the functions of the Appellate Authority.

**Under section 42** of the above Act, where any court or the Tribunal passes an order in appeal or revision to the effect that any tax assessed under this Act or the Central Sales Tax Act, 1956.

**Under Section 53** of the above Act where an order giving rise to refund is the subject matter of an appeal or further proceedings or where any other proceedings under this Act is pending.

Under the above Act Section 78, where in respect of any taxable goods, carried in a goods vehicle or held in stock by any dealer or on his behalf by any other person.

Under the above Act section 83, any authority including the Appellate Authority, Provisional Authority and Appellate Tribunal may, on an application or otherwise at any time within three years from the date of any order passed by it, rectify any error.

### BIHAR

**Appointment, jurisdiction and powers of the authority**

**Under section 10** of the Bihar Value Added Tax Act, 2005, there shall be the following classes of authorities to be appointed by the State Government, for carrying out the purposes of this Act:

- Commissioner of Commercial Taxes;
- Senior Joint Commissioner of Commissioner of Taxes;
- Joint Commissioner of Commercial Taxes,
- Deputy Commissioner of Commercial Taxes,
- Assistant Commissioner of Commercial Taxes,
- Commercial Taxes Officer;
- Asst. Commercial Taxes Officer,

the authorities appoint under sub-section (1) shall, within such areas or in respect of such transactions falling within an areas as the state government may, by notification specify, exercise such powers as may be conferred and perform such duties as may be imposed, by or under this Act.

**Under section 12** of the above Act the Tribunal constituted under section 9, or the Commissioner or any officer or authority appointed under section 10 or section 86 shall, for carrying out the purposes of this Act, have all the powers of a Civil Court under the Code of Civil Procedure, 1908.

**Under section 71** of the above Act where an order giving rise to a refund is the subject-matter of an appeal or further proceeding or where any other proceeding under this Act is pending.

**Under Section 78** of the Act The Commissioner may, after giving the parties a
reasonable opportunity of being heard in the matter, by order in writing after recording
is reason for so doing, transfer any proceedings or class of proceedings under any
provisions of this Act.

15.7 CHATTISGARH

Appointment, jurisdiction and powers of the authority

Under section 3 of the Chattisgarh Value Added Tax Act, 2005, there may be
appointed a person to be the Commissioner of [Commercial Tax] and the following
category of officers to assist him namely:

— Additional Commissioner of [Commercial Tax];
— Deputy Commissioner of [Commercial Tax];
— Assistant Commissioner or Additional Assistant Commissioner of
[Commercial Tax];
— [Commercial Tax] Officer or Additional [Commercial Tax] Officer;
— Assistant [Commercial Tax] Officer; and
— Inspector of [Commercial Tax].
— The Commissioner of [Commercial Tax] and
— The Additional Commissioner of [Commercial Tax]

shall be appointed by the State Government and the other officers referred to in sub-
section (1) shall be appointed by the State Government or such other authority as it
may direct. The Commissioner of [Commercial Tax] and the Additional Commissioner
or [Commercial Tax] shall exercise all the powers and perform all the duties conferred
or imposed on the Commissioner by or under this Act throughout the state and for
this purpose any reference to the Commissioner in this Act, shall be construed as a
reference to the Additional Commissioner of [Commercial Tax].

Under section 54 of the above Act, if Commissioner or the Appellate Deputy
Commissioner or the [Tribunal], in the course of any proceedings under this act is
satisfied that dealer has concealed his turnover or the aggregate of purchases prices
in respect of any goods or has furnished false particulars of his sales or purchases.

15.8 GOA

Appointment, jurisdiction and powers of the authority

Under section 13 of the Goa Value Added Tax Act, 2005, the Government by
notification of official gazette may appoint an

— Commissioner,
— Asstt. Commissioner,
— Additional Commissioner etc.

Under section 13(7) of the above Act no person shall be entitled to call in
question, in any proceeding, any jurisdiction including the territorial jurisdiction of any
officer or person appointed under sub-section (2) after the expiry of 30 days from the
date of receipt by such person any notice under this act, issued by such officer or
person. If within the period aforesaid a separate application in writing in the
prescribed form raising an objection as to the jurisdiction of any such officer or person is made to him, the officer or person shall refer the question to the Commissioner who shall after giving the person raising the objection a reasonable opportunity of being heard, make an order determining the question.

**Under section 16** of the above section the Tribunal and Commissioner interalia have the following powers of a Civil Court for the purpose of:

(a) proof of facts by affidavit;
(b) summoning and enforcing the attendance of any person, and examining him on oath or affirmation;
(c) compelling the production of documents; and (issuing commissions for the examination of witnesses.

**Under section 39** the Commissioner has revisional powers under any proceedings under the above Act.

**Under section 41** of the section, Tribunal has the power to rectify any error apparent of the record submitted by the assessee.

**15.9 GUJARAT**

Appointment, jurisdiction and powers of the authority

**Under section 16** of the Gujarat Value Added Tax Act, 2003, the State Government shall appoint Commissioner of Commercial Tax and specified number of:
- Joint Commissioners,
- Dy. Commissioners,
- Asstt. Commissioners,
- Commercial Tax Officers; and

Other Officers to assist the Commissioner of Commercial Tax in discharging his functions.

**Under section 17** of the above Act the commissioner has the power to transfer proceedings from one jurisdiction to another jurisdiction as per the circumstances.

**Under Section 20** of the above Act the Tribunal and the Commissioner have the following powers of civil courts for the purpose of:

(a) receiving of proof of facts on affidavit;
(b) summoning and enforcing the attendance of any person, and examining him on oath or affirmation;
(c) compelling the production of documents; and
(d) issuing commissions for the examination of witnesses.

In case of any affidavit to be made for the purposes of this act, any officer appointed by the Tribunal or the Commissioner may administer the oath to the deponent.
Test Your Knowledge

Under which of the following sections of the Gujarat Value Added Tax Act, 2003, does the commissioner have the power to transfer proceedings from one jurisdiction to another as per the circumstances?

(a) Section 20  
(b) Section 16  
(c) Section 17  
(d) Section 53  

Correct answer: (c)

15.10 HARYANA

Appointment, jurisdiction and powers of the authority

Under section 55 of the Haryana Value Added Tax Act, 2003, the State Government may appoint a Commissioner and specified number of;  
- Additional Excise and Taxation Commissioners,  
- Joint Excise and Taxation Commissioners;  
- Excise and Tax Officers;  
- Asstt. Excise and Tax Officers and

Other Officers to assist the commissioner for discharging his duties under this Act. The Commissioner shall have jurisdiction over the whole of the state and shall exercise all the powers conferred and perform all the duties imposed on the Commissioner, by or under this act, and other offices appointed shall exercise such powers as may be conferred and perform such duties as may be required by or under this Act in the area of jurisdiction as may from time to time be assigned to them.

Under section 46 of the Act the taxing authority and appellate authority has the same powers enjoyed by civil court.

Under section 47 of the Act such authorities can determine any person to be a dealer.

Under section 48 of the Act the authority has power to call the information from any person or company.

Under section 49 of the Act the same authority has the power to purchase under-priced goods.

Under section 50 the taxing authority has the power of transferring proceedings from one jurisdiction to another.

15.11 HIMACHAL PRADESH

Appointment, jurisdiction and powers of the authority

Under section 3 of the Himachal Pradesh Value Added Tax Act, 2005, the State
Government may, by notification, appoint a person to be the Commissioner and such other persons with such designations, as it thinks fit, State Government may by notification, appoint as many Assessing authorities as it may think fit. The commissioner and other persons appointed under sub-section (1) shall perform such functions and duties as may be required by or under this Act or as may be conferred, by the State Government by notification. The jurisdiction of the Commissioner and other officers posted at the State Headquarters shall extend to the whole of the state of Himachal Pradesh and the jurisdiction of other officers or officials shall, unless the State Government otherwise directs by notification extend to the districts or the areas of the districts for which they re for the time being posted.

**Under section 33** of the Act any Asstt. Excise and Taxation Commissioner or Excise and Taxation Officer appointed to assist the Commissioner under sub-section (1) of section 3 or an Excise and Taxation Officer duly authorized by the Commissioner.

**Under section 37** of the Act The Commissioner has power to call for information from Banking companies.

### 15.12 KARNATAKA

**Appointment, jurisdiction and powers of the authority**

**Under section 58** of the Karnataka Value Added Tax Act, 2003, the State Government may appoint

- a Commissioner of Commercial Taxes and
- as may Additional, Joint, Deputy, Assistant Commissioners,
- State Representatives and

Commercial Tax Officers, as they think for the purpose of performing the functions. The Commissioner may empower an officer not below the rank of an Asstt. Commissioner or an Advocate or a Chartered Accountant [or a Cost Accountant] or a Tax Practitioner.

**Under section 41** of the Act. The Commissioner has power of rectification of assessment or re-assessment in certain cases.

**Under section 51** of the Act The Commissioner has power to withhold refund in certain cases.

### 15.13 KERALA

**Appointment, jurisdiction and powers of the authority**

**Under section 3** of the Kerala Value Added Tax Act, 2003, the Commissioner shall have and exercise all the powers and shall perform all the duties conferred or imposed upon him by or under this Act. The Commissioner shall have Superintendence over all Officers and persons employed in the execution of this Act.

The Government shall appoint as many as Joint, Deputy Commissioners, Deputy Commissioners (Appeals), Asstt. Commissioner, Commercial Tax Officers and other officers.

The Government shall appoint an Appellate Tribunal consisting of a Chairman
and as many other members. The Chairman shall be a person who is or has been a Judicial Officer not below the rank of a District Judge.

**Under section 58** of the Act the Commissioner have powers of revision of the Commissioner suo motu.

**Under section 66** of the Act the Commissioner has power to rectify any error apparent on the face of the record.

**15.14 MADHYA PRADESH**

Appointment, jurisdiction and powers of the authority

**Under section 3** of the Madhya Pradesh Value Added Tax Act, 2002, the Taxing Authorities appointed a person to be:

- the Commissioner of Commercial Tax,
- Additional Commissioner of Commercial Tax;
- Deputy Commissioner or Additional Deputy Commissioner of Commercial Tax;
- Asstt. Commissioner or Additional Deputy Commissioner of Commercial Tax;
- Commercial Tax Officer or Additional Commercial Tax Officer,
- Inspector of Commercial Tax.

The Commissioner of Commercial Tax and the Additional Commissioner of Commercial Tax shall be appointed by the State Government and the other officers.

The Commissioner of Commercial Tax and the Additional Commissioner of commercial Tax shall exercise all the powers and perform all the duties conferred or imposed on the Commissioner by or under this Act. The state Government may, by order appoint any officer not below the rank of Deputy Commissioner, of commercial Tax as Appellate Authority.

**Under section 43** of the Act power of Commissioner and his assistants to take evidence on oath, etc.

**Under Section 44** of the Act power of Commissioner to call for information in certain cases.

**Under Section 45** of the Act, power of Commissioner to stay proceedings.

**15.15 MAHARASHTRA**

Appointment, jurisdiction and powers of the authority

**Under section 10** of the Maharashtra Value Added Tax Act, 2002, the State Sales Tax Authorities shall appoint an Officer to be called:

- the Commissioner of Sales Tax,
- Additional Commissioners of Sales Tax,
- Joint Commissioners,
- Sr. Deputy Commissioners,
- Deputy Commissioners,
- Assistant Commissioners,
- Sales Tax Officers and other officers and persons.
The Commissioner/All Officers other shall have jurisdiction over the whole of the State. The Commissioner shall have and exercise all the powers and perform all the duties. A Joint Commissioner shall save as otherwise directed by the Commissioner. Sr. Dy. Commissioners, Dy. Commissioners, Asstt. Commissioners, Sales Tax Officers, other officers and persons shall within their jurisdiction exercise such of the powers and perform such of the duties of the Commissioner under this Act.

Under Section 14 powers of Tribunal and Commissioner, the Tribunal and the Commissioner shall have all the powers of a Civil Court for this purpose.

Under Section 54 of the Act power to withhold refund in certain cases.

Under section 70 of the Act the Commissioner have Power to collect statistics

15.16 ORISSA
Appointment, jurisdiction and powers of the authority

Under section 3 of the Orissa Value Added Tax Act, 2004, the State Government shall for purposes of this Act, appoint a person to

— the Commissioner of Sales Tax,
— Special Commissioner,
— an Additional Commissioner,
— Joint Commissioner,
— a Deputy Commissioner,
— an Assistant Commissioner,
— a Sales tax Officer or
— an Assistant Sales Tax Officer
to assist the Commissioner. The Commissioner shall have jurisdiction over the whole of the State and the other persons appointed within such areas as the Commissioner may.

Under section 6 of the act the Commissioner have power to transfer proceedings.

Under section 60 of the act the Commissioner have power to withhold refund in certain cases.

15.17 PUNJAB
Appointment, jurisdiction and powers of the authority

Under section 4 of the Punjab Value Added Tax Act, 2005, the State Government by Notification in Official Gazette constitutes the tribunal to exercise the powers and discharge functions stated under the above act.

The tribunal consists of a Chairman, and three members appointed by the State Government. The Chairman shall be either retire judge of the High Court or a retired or serving officer of the Rank of Chief Secretary to the state Government or Secretary to Government of India.
**Under section 41** of the Act The commissioner have power to withhold round in certain cases.

**Under section 87** of the Act The Commissioner have power to summon witness and production of records and power to seek assistance from police officer or other officer.

**15.18 TAMILNADU**

**Appointment, jurisdiction and powers of the authority**

**Under section 55** of the Tamilnadu Value Added Tax Act, 2006, the State Government may appoint

- a Commissioner of Commercial taxes and as many
- Joint Commissioner of Commercial taxes,
- appellate Deputy Commissioner of Commercial taxes,
- Deputy Commissioner of Commercial taxes,
- Appellate Assistant Commissioner of Commercial taxes,
- Territorial Assistant Commissioner of Commercial taxes,
- Administrative Assistant Commissioner of Commercial taxes,
- Assistant Commissioner of Commercial taxes (Assessment),
- Assistant Commissioner of Commercial taxes (Enforcement), and
- Commercial Tax Officers and other officers shall perform the function.

**Under Section 54** State has power of revision of Deputy Commissioner.

**Under section 56** of the Act the Chairman of the Appellate Tribunal has power to transfer appeals.

**Under section 65** authority has power to order production of accounts and powers of entry, inspection, etc. and also powers to inspect goods delivered to a carrier or a bailee.

---

**Test Your Knowledge**

Under which of the following sections of the Tamilnadu Value Added Tax Act, 2006 Chairman of the Appellate Tribunal has power to transfer appeals.

(a) Section 56
(b) Section 55
(c) Section 54
(d) Section 53

**Correct answer: (a)**
15.19 UTTAR PRADESH
Appointment, jurisdiction and powers of the authority

Under section 55 of the Uttar Pradesh Value Added Tax Act, 2007, the State Government may appoint different dates in respect of different provisions.

Under section 39 of the act the State Government has power to grant instalment.

Under section 45 of the Act state government has power to order production of accounts documents and power of entry, inspection, audit.

Under section 46 the authority has power of search, inspection and seizure in case of a person other than dealer.

Under Section 47 of the Act the assessing authority has power to seek information and to issue summons.

Under section 48 of the Act an officer authorized under sub-section (1) of section 45 shall have the powers to seize any goods.

Under section 53 of the Act an officer exercising powers under the provisions of sections 45, 48, 50, 51 or 52 may take the assistance of police or other officers or officials of the state.

Under section 70 of the Act the State Government may make rules to carry out the purposes of this Act.

15.20 WEST BENGAL
Appointment, jurisdiction and powers of the authority

Under section 9 of the West Bengal Value Added Tax Act, 2003, all persons appointed under this act to exercise any power or to perform any function thereunder shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code, 1860 (45 of 1860).

Under section 19 of the Act the State Government may by notification, fix the rate of tax, with prospective or retrospective effect.

Under section 21 of the Act the state government after giving by notification not less than 14 days’ notice of its intention so to do, may by like notification with prospective or retrospective effect.

Under section 72 of the Act the authority has power of the Commissioner to stop delivery of goods and seizure of such goods.

Under section 88B of the Act the Commissioner has power to revise orders prejudicial to revenue.

Under section 91 of the Act the Appellate and Revisional Board, the Commissioner, the Special commissioner, the Additional Commissioner, or any
person appointed under sub-section (1) of section 6 to assist the Commissioner, shall for the purposes of this Act, have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (5 of 1908). Under sections 111, 112 the Commissioner has power to collect statistics from dealer and power of State Government to prescribe rates of fees and power of State Government to engage any person, firm or company to collect certain information’s and also power of state government to make rules.

Test Your Knowledge

The VAT system is applied by different States in India as an alternative to the Central Sales Tax System.

- True
- False

Correct answer: True

15.21 CERTIFICATION FOR PROFESSIONALS

As we know that the VAT system in India is not unique and every state and Union Territories have its own VAT Act or Rules; it becomes quite a difficult task to give a generalized picture regarding Certification of Documents by professionals applicable to all states or union territories. However, considering the above situation, in general terms a professional including a Company Secretary, has to see that all documents to be filed before VAT authorities are correct or not. Specially the calculation sheet, tax calculation sheet, TIN or GRN No., etc. Apart from this the Company Secretary has to see the returns to be filed before VAT authorities are made in prescribed rules. He is also taken into consideration the procedural aspects regarding payment of VAT and related assessment proceedings.

As a professional he has to see that whether the dealer has maintained the records and documents required under the Act. He has to advice the concerned client the provisions relating to appeals and revisions if any matter relating to VAT proceedings is undertaken by Appellate Tribunal or Court of Law as the case may be. Company Secretary has also be well versed with the technical aspects in dealing with seizure and confiscation procedure before judicial or quasi judicial bodies. Besides this a professional dealing with VAT authorities has to carefully vouch and take careful steps with regard to books of accounts, and return procedures annually.

Every state has its own peculiarities regarding to documents to be filed before the VAT authorities in connection with filing of return and other related issues. The technicalities and calculation of tax is an important component of services is to be provided by professional under VAT authorities in India. Any mistakes or errors can put the client in great displeasure and anxiety.
LESSON ROUND UP

- This chapter covers the legislative provisions in different states in which VAT has been implemented, relating to the appointment, jurisdiction and powers of the authorities. Also in this chapter the reader will get information regarding certification for professionals.

SELF TEST QUESTIONS

1. Discuss briefly the powers of the VAT authorities of Andhra Pradesh, Haryana and Maharashtra.
2. Explain briefly the procedures relating to the appointment of Chairman and other officers under VAT regime in the states of West Bengal, Gujarat and Tamilnadu.
In this chapter the VAT provisions in different countries and corresponding practices in GST Scheme or VAT Scheme has been adequately covered. It has been observed that the standard practice in the developed countries relating to Sales Tax is to follow the GST Scheme. The practice depends upon the peculiarities of individual countries or trade blocks as well as the International Trading System of goods and services. The Chapter also covers the poignant role, the Company Secretaries play in their professional capacity before any VAT authorities in our country. As a matter of fact, it is also being observed that the acceptability of company secretaries before the VAT authorities are increasing day by day.

LEARNING OBJECTIVES

This chapter covers the following topics:

- VAT in other Countries
  - Australia
  - Canada
  - The European Union
  - France
  - Germany
  - United States
- Role and Position of Company Secretaries

16.1 VAT IN OTHER COUNTRIES

VAT does not primarily link tax liability to residence. This means that also foreign companies can become liable for VAT in countries other than the country where they have their business establishment.

Transactions for the supply of goods or services are normally covered by a sales contract or sales conditions. If drawn carefully, these contracts or sales conditions will also contain tax clauses. Such clauses are governed by contract law, which means that their contents should be distinguished from the legal situation according to tax law.

In order to be sure that both parties, i.e., supplier and customer, are fully aware of the
VAT (but also e.g., customs, excise, sales tax) treatment, it is recommendable to verify the tax clauses of the contract or sales conditions before the agreement is concluded.

Value Added Tax (VAT) is a type of sales tax. In some countries, including Australia, Canada, New Zealand and Singapore, this tax is known as “goods and services tax” or GST; and in Japan it is known as “consumption tax”. VAT is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer). As VAT is intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT or VAT is refunded.

VAT was first introduced in France in 1954. Worldwide more than 130 countries have adopted VAT. List of few countries that collect VAT include: Algeria, Argentina, Azerbaijan, Bangladesh, Belarus, Belgium, Brazil, Bulgaria, Camerooon, Chile, China, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Guatemala, Guyana, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Latvia, Lebanon, Lithuania, Luxembourg, Malta, Mexico, Monaco, Montenegro, Morocco, Netherlands, Norway, Pakistan, Panama, Peru, Philippines, Poland, Portugal, Romania, Russia, Senegal, Serbia, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Taiwan, Thailand, Tunisia, Turkey, Ukraine, United Kingdom, Uruguay, Uzbekistan, Venezuela, Vietnam, Zambia.

AUSTRALIA

The alleged high administrative and compliance costs associated with the VAT, relatively larger scope for tax evasion compared to retail sales tax, overstated claims for tax credit as a potential loophole and concerns expressed by trade unions regarding regressivity of the VAT have been cited as some of the reasons for Australia deciding against the VAT. However, according to some others, the real reason against introduction of the VAT in Australia has been the far greater lead time required, of the order of an additional twelve months, for securing the approval of Parliaments compared to retail sales tax as it would be practically impossible to get any law passed through the Australian Parliament, which has a term of only three years.

CANADA

There is federal VAT, the Goods and Services Tax (GST), that applies throughout the country. In one province, namely, Alberta, the GST is the only sales tax. In four provinces, namely, British Columbia, Saskatchewan, Manitoba, and Ontario, in addition to the GST, there is the only sales tax (RST) applied to the GST-exclusive tax base. In one province, Prince Edward Island, the provincial RST is applied to the GST-inclusive tax base, in three provinces, Newfoundland, Nova Scotia, and New Brunswick, there is a joint federal-provincial VAT, called the Harmonized Sales Tax (HST) and administered by the federal government at a uniform rate of 15 per cent.

THE EUROPEAN UNION

The value added tax was perceived by the member-countries of the European Union as the ideal means to “promote neutrality and uniformity of the tax burden and to provide incentives for increased productivity and industrialization. Though the EC Fiscal and Financial Committee had recommended as early as 1962 that all member-
countries should shift to the VAT system, the change for the original members was completed only in 1973 when Italy switched over to the VAT. However, certain other recommendations of the committee regarding uniformity of rates and eventual adoption of the original principle for taxation of trade within the EC were not implemented immediately.

Test Your Knowledge

Which of the tax is applicable in the province of Alberta in Canada?
(a) Goods and Services Tax (GST)
(b) only sales tax (RST)
(c) Harmonized Sales Tax (HST)
(d) Value Added Tax (VAT)

Correct answer: (a)

FRANCE

The Value Added Tax (VAT) had its origin only in France. The latest innovation is the value-added tax. Its emergence in France illustrates the process by which a sort of continuing ferment of improvisation now and then gives rise to an invention of the first order. They were the first Europeans to adopt it in 1954. A new Regulation was introduced in France regarding VAT transaction. Since September 1st, 2006 according to Article 283-1 of the FTC when a supply of goods or services is carried out by a French VAT liable entity non-established in France, VAT must be self-assessed by the buyer when he is VAT identified in France. VAT registration is mandatory for intra-EU operations. When the supplier is not established in E.O., the Respondent is necessarily get its Fiscal Representative nominated through application under Article 289A of French Tax Code (FTC).

GERMANY

On January 1, 1968, Germany replaced its multi-point sales tax on goods and services, which extended down to the retail stage, by a VAT with a normal rate of 10 per cent and a reduced rate of 5 per cent on foodstuffs and agricultural products like raw wool raw hides, and timber. The switchover to the VAT was meant to be revenue-neutral and was not expected to have any tangible effect on prices.

UNITED KINGDOM

The VAT was introduced in the United Kingdom on 1 April, 1973. As in Spain, this was in fulfillment of one of the key conditions for entry into the European Community. It is destination-based, general consumer expenditure tax chargeable on all supplies of goods and services in the country, barring those which are exempted or zero-rated. The tax is expected to be borne by the final consumer, though collected at each stage of production/trade. The VAT replaced two of the major indirect taxes levied in the UK earlier, viz., the Purchase Tax (PT) on commodities and the Selective Employment Tax (SET). The PT was a single stage tax on wholesalers that had to make a distinction which was often difficult to draw between
goods and services and between different categories of dealers and goods. The purchase tax was then chargeable at three different rates—25 per cent, 18 per cent and 11.15 per cent and these rates represented substantial reductions from previous levels in preparation for the introduction of the VAT on the wholesale values of many goods. The SET was a tax essentially on selected services. The Government felt that these taxes were inferior to a tax on the value added that could be applied to consumer expenditures comprehensively. On several counts, the VAT clearly offered a better instrument of taxation. Then there was the EC requirement. It should, however, be noted that UK would have gone in for the VAT in any case because of its intrinsic merits.

UNITED STATES

The United States, with a federal structure, provides an important case study for consideration of the VAT for any federal economy in general. Even though the United States has been interested in the VAT for the last thirty years, its actual introduction in the US does not seem to be anywhere near the horizon. The main reason for this situation is that the United States does not merely appear to be satisfied with its existing state retail sales taxes but the possibility of the federal government usurping the states’ powers of sales taxation has been keeping it away from the VAT at a respectable distance. Although attempts for a federal level VAT date as far back as the proposal by T.S. Adams in 1921, it was in 1972 that the VAT was recommended as a source of revenue for providing relief on residential property taxes. The proposed Tax Restructuring multiple rates between 10 and 15 per cent. In the late seventies, Congressman Ulman came up with a proposal for the VAT to replace part of the pay roll tax, personal income tax and corporate income tax for $50 billion and $28 billion respectively. This proposal was subjected to a great deal of public debate even after 1980 when Ulman lost his election.

Test Your Knowledge

Which of the following indirect taxes were replaced by VAT in UK?
(a) Purchase Tax (PT)
(b) Selective Employment Tax (SET)
(c) Harmonized Sales Tax (HST)
(d) Goods and Services Tax (GST)

Correct answer: (a) and (b)

16.2 ROLE AND POSITION OF COMPANY SECRETARIES

The profession of Practising Company Secretaries, which made a humble beginning in the sixties, has now reached greater heights. With the blended knowledge of various laws, the Practising Company Secretaries are versatile professionals capable of rendering wide range of services in diversified fields including VAT.
(1) Authorized representative before VAT authorities:

The Company Secretaries play poignant role in their professional capacity before VAT authorities in our country. The acceptability of company secretaries before the VAT authorities is increasing day by day. Company Secretaries in Practice have now been recognized to act as an authorized representative for the purpose of appearing before VAT authorities under Statutes of various States like:

- West Bengal Value added Tax Rules, 2005 under Rule 2(1)(a)(iv) of the Rules;
- Bihar Value added Tax Act, 2005, under Section 87(d) of the Act;
- Daman and Diu Value added Tax Regulation, 2005, under Section 82(1)(b) of the Regulation;
- Goa Value added Tax Act, 2005, under Section 82(1)(b) of the Act;
- Gujarat Value added Tax Act, 2003 under Section 81(1)(c) read with Rule 59(1)(a) of the Gujarat Value added Tax Rules, 2005;
- Karnataka Value added Tax Act, 2003 under Section 86(c) read with Rule 168(2)(c)(iv)(b) of the Karnataka Value added Tax Rules, 2005;
- Arunachal Pradesh Goods Tax Act, 2005 under Section 83(1)(c) read with Rule 78(1)(a) of the Arunachal Pradesh Goods Tax Rules, 2005 etc.
- Kerala Value added Tax Act, 2003 under Section 86(e).

(2) Certification of Documents:

Moreover, the VAT system in India is not unique and every state and Union Territories have its own VAT Act or Rules; it becomes quite a difficult task to give a generalized picture regarding Certification of Documents by professionals applicable to all states or union territories. A professional including a Company Secretary, has to see that all documents to be filed before VAT authorities, specially the calculation sheet, tax calculation sheet, TIN or GRN No., etc.

(3) Filing of returns:

The Company Secretary has to see the returns to be filed before VAT authorities are made in prescribed rules. He should also consider the procedural aspects regarding payment of VAT and related assessment proceedings. Every state has its own peculiarities regarding the documents to be filed before the VAT authorities in connection with filing of return and other related issues.

(4) Scrutiny of records and advising to clients:

As a professional he has to see that whether the dealer has maintained the records and documents required under the Act. He has to advice the concerned client the provisions relating to appeals and revisions if any, matters relating to VAT proceedings is undertaken by Appellate Tribunal or Court of Law as the case may be. Company Secretary has to be well versed with the technical aspects in dealing with seizure and confiscation procedure before judicial or quasi judicial bodies. Besides this a professional dealing with VAT authorities has to carefully vouch and take careful steps with regard to books of accounts, and return procedures annually. The technicalities and calculation of tax is an important component of services to be provided by professional under VAT authorities in India.
VAT Audit

Company Secretaries are authorised to conduct VAT Audit under the Jharkhand Value Added Tax Act, 2005.

LESSON ROUND UP

- This chapter evaluates the standard practices followed with regard to VAT Scheme or GST Scheme in different countries and block of countries.
- The Chapter also states about the role of Company Secretaries before VAT authorities in different states of our country.

SELF TEST QUESTIONS

1. Discuss the role of Company Secretaries in the professional capacity before VAT authorities in our country.

2. Explain briefly the practices followed in developed countries with regard to goods and services tax.

3. How the practice followed specially in Western Countries is different from practices followed in our country under VAT regime.
This Test Paper set contains five test papers. Test Paper 1/2012, 2/2012, 3/2012, 4/2012 and 5/2012. The maximum time allowed to attempt each test paper is 3 hours.

Students are advised to attempt at least one Test Paper from Test Papers 3/2012, 4/2012 and 5/2012 i.e. either Test Paper 3/2012 or Test Paper 4/2012 or Test Paper 5/2012 and send the response sheet for evaluation to make him/her eligible for Coaching Completion Certificate. However, students may, if they so desire, are encouraged to send more response sheets including Test Paper 1/2012 and 2/2012 for evaluation.

While writing answers, students should take care not to copy from the study material, text books or other publications. Instances of deliberate copying from any source will be viewed very seriously.
WHILE WRITING THE RESPONSE SHEETS TO THE TEST PAPERS GIVEN AT THE END OF THIS STUDY MATERIAL, THE STUDENTS SHOULD KEEP IN VIEW THE FOLLOWING WARNING AND DESIST FROM COPYING.

WARNING

Time and again, it is brought to our notice by the examiners evaluating response sheets that some students use unfair means in completing postal coaching by way of copying the answers of students who have successfully completed the postal coaching or from the suggested answers/study material supplied by the Institute. A few cases of impersonation by handwriting while answering the response sheets have also been brought to the Institute’s notice. The Training and Educational Facilities Committee has viewed seriously such instances of using unfair means to complete postal coaching. The students are, therefore, strongly advised to write response sheets personally in their own hand-writing without copying from any original source. It is also brought to the notice of all students that use of any malpractice in undergoing postal or oral coaching is misconduct as provided in the explanation to Regulation 27 and accordingly the studentship registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute”. 
1. (a) What deductions are allowed in computing taxable income under the head ‘Income from Other Sources’? Explain. (5 marks)

(b) Can brought forward loss in the following cases be set off:
   1. Partnership firm taken over by one or more partners.
   2. Brought forward loss of a firm succeeded by another firm.
   3. Brought forward loss of the business of HUF where the business of the HUF has been taken over by one of the members of HUF.
   4. Brought forward loss of Proprietary business taken over by a firm consisting of the sole proprietor as partner.
   5. Brought forward loss of amalgamating company where such company has amalgamated with another company. (1 mark each)

(c) Gyan owns a house property in Delhi. 60% of the property is let out for ₹15,000 p.m and 40% portion is self occupied by him.

The details of the house property are as follows:

- Municipal value of the house: ₹2,00,000
- Fair rent: ₹22,000 p.m
- Standard rent: ₹20,000 p.m
- Municipal taxes paid: ₹30,000
- Interest on money borrowed for purchase of house property which was acquired in 2005: ₹1,80,000

Compute the income from house property, for the Assessment Year 2012-13. (10 Marks)

2. (a) Explain in brief the provision of Section 45(1A) in case of damage or destruction of capital asset. (5 marks)

(b) Mr. Rahul supplies you the following information for the year ended 31.03.2012.

   (i) Interest on bank deposits: ₹60,000
   (ii) Dividend on shares of foreign companies received abroad: ₹40,000
   (iii) Interest from deposits in Indian Companies (gross): ₹38,000
(iv) Income from horse race in India  

Mr. Rahul is a resident. He has donated a sum of ₹20,000 to Municipal Corporation of Delhi for family planning. He has paid ₹8000 by credit card to New India Assurance Company for mediclaim for himself. He has also spent ₹16,000 on medical treatment of his minor son who is physically handicapped.

Compute total income of Mr. Rahul for the assessment year 2012-13.  

(c) Briefly explain and illustrate how the tax liability of an assessee is determined with reference to residence.  

3 (a) Write Short Notes on:  

   (i) Belated Return of income.  
   (ii) Income of Political Parties under Section 13A.  

(b) What are the essential conditions for claiming exemption under section 11 in the case of charitable trust.  

4. (a) Vikram transferred agricultural land permanently to Yatin with a condition that 25% of the income from the land should be handed over to him. Yatin earned an income of ₹40,000 from the transferred property. What are the tax implications in the hands of Vikram?  

(b) The net wealth of a firm consisting of three partners A, B and C, having equal share and a capital contribution of ₹7,00,000, ₹3,00,000 and ₹2,00,000 respectively is under:  

   (i) Value of assets located outside India ₹ 20,00,000  
   (ii) Value of assets located in India ₹ 50,00,000  
   (iii) Debts incurred in relation to assets located in India ₹ 10,00,000  

Compute the value of the interest of each partner in the firm assuming C is non-resident in India.  

(c) Discuss in brief the deduction in respect of medical insurance premium.  

5. (a) What are the provisions of section 54F in relation to capital gain on transfer of asset, other than a residential house?  

(b) What is meant by ‘pay-as-you-earn’ scheme?  

(c) Discuss the special provisions for computing profits and gains of shipping business in the case of Non-Residents under section 44B.  

6. (a) Explain the provisions of set-off of loss from one head against income from another head under section 71.  

(b) What are the provisions for inclusion of income of a minor child?  

(c) How is the Total Income of an individual computed?
TEST PAPER 2/2012
(This test paper is based on study lessons 11 to 16)

Time allowed: 3 hours  Max. marks: 100

NOTE: Attempt ALL Questions.

1. (a) What are the different modes of computation of Value added tax (VAT) and what are the advantages of adoption of tax credit method?  
   (8 marks)

   (b) What is the due date for payment of service tax? What is the rate of interest for delayed payment and penalty for default in payment of service tax?  
   (8 marks)

2. (a) Explain the provision regarding service tax on Company Secretaries.  
   (4 marks)

   (b) Explain in brief the provisions of service tax regarding following:
   (i) Registration procedure under service tax  
   (ii) Doctrine of unjust enrichment  
   (iii) Adjustment of excess payment  
   (iv) Filing of return under service tax.  
   (4 marks)

3. (a) What do you mean by ‘Reverse Charge’ and under which circumstances the service receivers are liable to pay service tax? Indicate such cases.  
   (10 marks)

   (b) Discuss the ‘Advance Ruling’ provisions in service tax.  
   (6 marks)

4. (a) Write notes on the following:
   (i) Registration under VAT  
   (ii) Filing of return under VAT  
   (iii) Rates of VAT  
   (4 marks each)

   (b) Discuss the advantages of introduction of VAT in India.  
   (4 marks)

5. (a) What do you mean by ‘taxable services’ in the context of service tax? What is the general rule regarding valuation of taxable services?  
   (8 marks)

   (b) What do you mean by Exempt Sale and how it is different from Zero Rating Sale?  
   (8 marks)

6. (a) Explain briefly the Credit and Set-off provisions under VAT.  
   (6 marks)

   (b) Discuss the jurisdictional powers of VAT authorities in the following states:
   (i) Karnataka  
   (ii) Tamilnadu.  
   (5 marks each)
1. (a) Choose the most appropriate answer from the given options in respect of the following:

(i) Under section 32 of the Income Tax Act, 1961, licences are depreciated @--------------.
   (a) 10%
   (b) 15%
   (c) Nil rate
   (d) 25%.

(ii) Expected rent shall be higher of the;
   (a) Municipal value and standard rent
   (b) Fair rent and actual rent received
   (c) Standard rent and Fair rent
   (d) Municipal Value and Fair rent.

(iii) Under section 10(10), the maximum amount of gratuity received which is not chargeable to tax shall be;
   (a) ₹ 3,50,000
   (b) ₹ 3,00,000
   (c) ₹ 2,50,000
   (d) ₹ 10,00,000

(iv) Loss from business can be set-off against other income in subsequent assessment year except:
   (a) Income from speculation business
   (b) Income under the head house property
   (c) Income under the head other sources
   (d) Income under the head Salaries.

(v) Every Domestic Company having total income exceeding ₹1 crore then the income tax shall be increased by the surcharge at the rate________on such Income Tax:
   (a) 5%
   (b) 10%
   (c) 7.5%
   (d) 2% 

(1 mark each)
(b) State, with reasons in brief, whether the following statements are true or false:

(i) When annual value of one self occupied house is nil, the assessee will be entitled to the standard deduction @20%.

(ii) Special provisions of section 44AD for computing profits and gains of business on presumptive basis shall not be applicable if the total turnover of such retail trade exceeds rupees 40 lakhs.

(iii) Zero coupon bond held for more than 12 months but less than 36 months treated as long term capital asset.

(iv) The rate of Dividend Distribution Tax for financial year 2011-12 is 15%.

(v) Interest free loan to an employee, where the amount of loan does not exceed ₹30,000 shall be treated as the tax-free perquisites.

(1 mark each)

(c) Mr. Madhur submits the following information for previous year 2011-12 relevant to the assessment year 2012-13:

1. Profit from Business A situated in Delhi 2,50,000
2. Profit from Business B situated in Bombay 80,000
3. Loss from Business C carried in New York (the business is controlled from India but profits are not received in India) 40,000
4. Unabsorbed depreciation of business C 35,000
5. Income from house property situated in India 15,000
6. Income from house property situated in London (rent received in London) 20,000

Find out the Gross Total Income of Madhur for the Assessment Year 2012-13. (5 marks)

2. (a) Write short notes on the following:

(i) Cost of Acquisition

(ii) Amortisation of telecom license fee (5 marks each)

(b) Raghav sold gold ornaments on 16-07-2011 for a sum of ₹10,00,000. This gold was purchased in 1978 for ₹60,000 by his father. The fair market value of the gold as on 01-04-1981 was ₹1,00,000. His father gifted the gold to Raghav on 15-07-2011. He spent ₹2,00,000 till 31-07-2011 (the due date for filing of the return) on construction of a house property and deposited ₹5,00,000 on 31-07-2011 under capital gain scheme and spent a sum of ₹4,00,000 for construction of the house property till the stipulated time. Compute the capital gain chargeable to tax on this transaction for various relevant assessment year. (5 marks)

3. (a) Re-write the following sentences after filling up the blank spaces with appropriate word(s)/figure(s):

(i) An income derived from land situated in India is ________________.

(ii) Under section 44BB, ________________ includes ships, aircraft, vehicles,
drilling units, scientific apparatus and equipment used for the purposes of the business of exploration of mineral oils.

(iii) No notice under section 143(2) shall be served on the assessee after the expiry of __________ from the end of financial year in which return is furnished.

(iv) Senior citizen means an individual resident in India who is of the age of __________ years or more at any time during the relevant previous year.

(v) For belated filing of income tax return, the assessee is liable to pay interest @ __________ for every month.  

(b) Distinguish between the following:

(i) “Defective return of income” and “Belated return of income”

(ii) “Normal depreciation” and “Additional depreciation”

(5 marks each)

4. (a) How the valuation of Jewellery to be made under Wealth Tax Act, 1957.

(4 marks)

(b) Examine the applicability of the the provisions of section 40A(3) in the following cases:

(i) Riyan purchases goods in cash from his brother for ₹40,000, whose market value is ₹35,000.

(ii) Riyan purchases a building for ₹10,00,000 and makes the payment in cash.

(iii) Riyan makes a purchase of goods of ₹60,000 and makes payment of ₹45,000 by account payee cheque and ₹15,000 in cash.

(2 marks each)

(c) Compute the net wealth of R from the following details as on 31-03-2012 for the assessment year 2012-13. The individual is engaged in the business of processing and selling of gold and silver articles and ornaments in India and outside India:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Balance</td>
<td>4,30,000</td>
</tr>
<tr>
<td>Unaccounted cash balance</td>
<td>70,000</td>
</tr>
<tr>
<td>Gold articles</td>
<td>25,00,000</td>
</tr>
<tr>
<td>Jewellery made of silver</td>
<td>14,00,000</td>
</tr>
<tr>
<td>Guest house</td>
<td>35,00,000</td>
</tr>
<tr>
<td>Motor cars</td>
<td>6,40,000</td>
</tr>
<tr>
<td>Factory Building</td>
<td>8,00,000</td>
</tr>
</tbody>
</table>

R has taken a loan of ₹8,00,000 by mortgaging guest house for purchasing factory building.  

(5 marks)

Part B

5. (a) Re-write the following sentences after filling up the blank spaces with appropriate word(s)/figure(s):

(i) Return of service tax filed in Form No. ____________
(ii) Every person whose aggregate value of taxable service exceeds ₹___________ liable to pay Service tax electronically.

(iii) An assessee may submit a revised return in form No. ST-3 in triplicate to correct a mistake or omission within a period ___________ from the date of submission of return under Rule 7.

(iv) The provisions relating to valuation of service tax are contained in section ___________ of the Finance Act, 1994.

(v) Excess service tax paid may be adjusted with a monetary limit of ₹___________ for a relevant month or quarter as the case may be.

1 mark each)

(b) Write short notes on:
(i) Services Tax Return
(ii) Input VAT Credit
5 marks each)

(c) When does a small service provider require to register under the Service Tax Act, but not liable to collect and pay service tax. 5 marks)

Part C

6. (a) Compute the invoice value to be charged and amount of tax payable under VAT by a dealer who had purchased goods for Rs 2,00,000 and after adding expenses of ₹10,000 and of profit of ₹25,000 had sold out the same.

The rate of VAT on purchases and sales is 12.5%. 5 marks)

(b) On what type of purchases input tax credit is not available. Enumerate.
5 marks)

(c) "A registered dealer can set off the amount of input tax against the amount of his output tax‖. Explain.
5 marks)

(d) Explain the procedure of registration under value added tax(VAT).
5 Marks)
Part A

1. (a) Choose the most appropriate answer from the given options in respect of the following:

(i) In what status Limited Liability Partnership is taxed under the Act:
(a) Individual
(b) LLP
(c) Firm
(d) Corporate.

(ii) Income earned and received outside India in 2001-02 but remitted to India in the financial year 2011-12, is taxable in the hands of
(a) Resident
(b) Resident but not ordinarily resident
(c) Non-resident
(d) None of the above.

(iii) The maximum amount not chargeable to tax for very senior citizen shall be an amount equal to:
(a) 2,50,000
(b) 2,40,000
(c) 1,80,000
(d) 5,00,000

(iv) The method of accounting for computing income is the method of accounting regularly employed by the assessee under the head:
(a) House Property
(b) Capital Gain
(c) Salaries
(d) Profits and gains from Business or profession

(v) A company is said to be a resident in India in previous year, if:
(a) It is an Indian company
(b) The control and management is wholly situated in India
(c) Either it is an Indian company or the control and management is wholly situated in India
(d) It is both an Indian Company and the control and management is wholly situated in India.  

(1 mark each)
(b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) The income of minor child shall be taxable in excess of ₹------------- in the hands of parents.

(ii) Provisions of section 44AD shall not apply where gross receipts exceed -----------------.  

(iii) Paintings are considered as -------------- as per section 2(14) of Income Tax Act, 1961.

(iv) Wealth Tax is levied on the net wealth of a person as on 31st March, this date is known as -------------.

(v) It is obligatory for an assessee to pay advance tax where the amount of tax payable is ₹---------------- or more.  

(1 mark each)

(c) An assessee used to file his return of income showing income from rent on receipt basis and was assessed accordingly up to the assessment year 2012-13. During the financial year 2011-12, he received a sum of ₹1,00,000 by way of enhancement for the last six years as the Government department (tenant) enhanced the rate of rent with retrospective effect. Will the sum of ₹1,00,000 be taxable in the assessment year 2012-13? Can it be spread over the last six years? Is there any provision of tax relief in such cases, like section 89(1) of the Income Tax Act, 1961? What are the provisions of the Act governing such cases?  

(5 marks)

2. (a) 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.  

(2 marks each)

(b) From the following particulars submitted by Raju. Compute his income from other sources for the assessment year 2012-13.

Director’s meeting fees received from Y Ltd  
Agricultural income from land situated in India  
Agricultural income from Nepal  
Interest:
(a) from bank on FDR (Net)  
(b) on post office saving account  
(c) on Government securities  
(d) on Public Provident Fund  
(e) on National Savings Certificate VIII issue  
    Dividend from A Limited declared on 25-08-2011  
    Lottery prize received after T.D.S  
    Rent from Sub Letting of a flat  

(rent paid to landlord for the flat is ₹6,000)  

(5 marks)
Raju spent ₹600 for realizing the rent. He had also spent ₹10,000 for the purchase of lottery tickets and received the prize on one ticket.  

(5 marks)


(4 marks)

3. (a) State whether the following statement are True or False  
   (i) An assessee shall be allowed deduction of payment of electricity bill of the house under the head Income from House Property.  
   (ii) Deduction in respect of maintenance including medical treatment of a dependent who is a person of disability shall be allowed to a non-resident or a resident in India.  
   (iii) Only 25% of Income from growing and manufacturing of rubber is liable to tax.  
   (iv) Interest received on enhanced compensation is chargeable under the head Capital Gains.  
   (v) Remuneration received by Member of Parliament are taxable under the head “Income from other sources”.  

(1 mark each)

(b) Riya has a house property in Delhi whose particulars are as under:

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal Value</td>
</tr>
<tr>
<td>Standard Rent</td>
</tr>
<tr>
<td>Municipal Taxes Paid</td>
</tr>
<tr>
<td>Interest on money borrowed for acquiring the house after 01-04-2009</td>
</tr>
<tr>
<td>Period of occupation for own residence</td>
</tr>
<tr>
<td>Actual rent for 10 months</td>
</tr>
</tbody>
</table>

Compute the income from house property for assessment year 2011-12.  

(5 marks)

(c) Is it compulsory to file a return of income? If so what is the time limit for submission of the return of Income.  

(5 marks)

4. (a) What do you mean by HUF. Is the share of income of HUF received by member taxable in his hands?  

(5 marks)

(b) From the following particulars, calculate the taxable income of Suman for the assessment year 2012-13:

<table>
<thead>
<tr>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary per month</td>
</tr>
<tr>
<td>Dearnness Allowance per month</td>
</tr>
<tr>
<td>Medical bill reimbursed (out of which ₹14,000 is spent on treatment of specified Ailment in a hospital approved by the Chief Commissioner)</td>
</tr>
<tr>
<td>Free telephone at residence</td>
</tr>
<tr>
<td>House Rent Allowance per month (Rent paid ₹15,000 p.m for a house in Delhi)</td>
</tr>
</tbody>
</table>

(5 marks)
House property is let out on a monthly rent of ₹2,000. The annual value of the house property is ₹30,000. Municipal tax paid is ₹1800 for whole year. Re-payment of house building loans taken from friends is ₹5,000 and from Life Insurance Corporation is ₹9,000 (which includes ₹6,000 on account of interest)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on Savings Bank A/c</td>
<td>34,000</td>
</tr>
<tr>
<td>Interest on PPF A/c</td>
<td>2,000</td>
</tr>
<tr>
<td>Income from units of Unit Trust of India</td>
<td>800</td>
</tr>
<tr>
<td>Life Insurance Premium</td>
<td>6,000</td>
</tr>
<tr>
<td>Contribution to PPF</td>
<td>6,000</td>
</tr>
<tr>
<td>Deposit in Account under National Savings Scheme, 1992</td>
<td>10,000</td>
</tr>
<tr>
<td>Interest accrued on (NSC VIII Issue)</td>
<td>34,000</td>
</tr>
</tbody>
</table>

The construction of the building was completed on 01-01-1993.

(10 marks)

Part B

5. (a) What do you mean by ‘Reverse Charge’ and under which circumstances the service receivers are liable to pay service tax? Indicate such cases

5 marks)

(b) What is the due date for payment of service tax? What is the rate of interest for delayed payment and penalty for default in payment of service tax? (5 marks)

(c) State whether the following statement are True or False

(i) Service tax is payable on issue of invoice or receipt of payment whichever is earlier.

(ii) Service tax is always paid by the service provider.

(iii) Separate returns will have to be filled if multiple services are provided.

(iv) Service tax is payable on the market value of services even if free services are provided.

(v) Separate registration under service tax has to be applied for every taxable service provided. (1 mark each)

(d) What are conditions subject to which excess payment can be adjusted? Explain. (5 marks)

Part C

6. (a) State whether the following statement are True or False:

(i) Input credit is payable on account of VAT paid on capital goods.

(ii) TIN stand for Tax Payer’s Identification Number and it is code number to identify a tax payer, having 11 digit numerals allotted for the entire country.

(iii) A special Vat rate of 1% is prescribed for precious and semi precious metals.
(iv) Haryana was the first state to implement VAT with effect from 1st April, 2003.

(v) Under Zero rated sales, prior stage tax is set off against the 0% tax paid, and effectively the entire tax paid on purchases is eligible for refund. (1 mark each)

(b) Discuss, with suitable example, various methods for computation of VAT liability. (5 marks)

(c) Write Short Notes on the following:
   (i) Zero rating
   (ii) Rates of Value Added Tax. (5 marks each)
TEST PAPER 5/2012
(This test paper is based on entire Study Material)

Time allowed: 3 hours Max. marks: 100

NOTE: Attempt ALL Questions.

Part A

1. (a) Choose the most appropriate answer from the given options in respect of the following:
   (i) Leave encashment is exempt to the extent of maximum of the following:
   (a) ₹ 3,50,000
   (b) ₹ 3,00,000
   (c) ₹ 10,00,000
   (d) ₹ 2,50,000
   (ii) Any rent or revenue derived from land may be treated as agricultural income if:
   (a) It is derived from land
   (b) the land is situated in India
   (c) the land is used for agricultural purpose
   (d) all the above conditions are satisfied
   (iii) Which of the following is covered under section 80D of the Income Tax Act, 1961:
   (a) Repayment of loan taken for higher education
   (b) Medical treatment of handicapped dependent
   (c) Medical insurance premium
   (d) Reimbursement of medical expenses
   (iv) Transport allowance granted to a handicapped employee per month to meet expenditure for the purpose of commuting from office to residence is exempt to the extent of rupees:
   (a) 1600
   (b) 800
   (c) 500
   (d) 1000
   (v) The deduction allowable in respect of interest on enhanced compensation taxable under the head 'income from other sources' is:
   (a) 50%
   (b) 30%
   (c) 15%
   (d) Nil

(1 mark each)
(b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) The assessee shall not be eligible for relief under section 89 in case he claimed exemption under section ___________

(ii) Under section 2(22AAA), ____________ means a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government.

(iii) Income of a minor child clubbed in the hands of parents, where it exceeds__________.

(iv) Expenditure incurred in respect of preliminary expenses is allowed as deduction under section _____________.

(v) Exemption under section 54 is available in respect of ___________.

(1 mark each)

(c) Capital gain arises in the previous year in which the transfer took place. Discuss. Are there any exceptions to this rule? (5 marks each)

2. (a) Compute the net wealth of Rajan, a resident individual, as on 31st March 2012 from the following particulars:

(i) He has a house property at Delhi valued at ₹22,00,000 which is used for business purposes.

(ii) Vehicles for personal use – Motor car: ₹ 8,50,000; Motor Van: 4,50,000; and Jeep: ₹3,54,000

(iii) Cash in hand: ₹4,50,000

(iv) Jewellery: ₹15,60,000; and

(v) He had transferred an urban house plot in February 2012 in favour of his niece, which was not revocable during her life time. His niece died on 14th March, 2012 and Rajan could get the title of plot re-transferred to his name on 15th April, 2012. Market value of house plot as on 31st March, 2012 is ₹14,10,000. (7 marks)

(b) Explain the provisions relating to taxation of Winning from Lotteries. (4 marks)

(c) What are the provisions for inclusion of income of a minor child? (4 marks)

3. (a) State with reasons whether the following expenses are admissible as deduction while computing "Income from Other Sources".

(i) Interest of ₹10,000 paid on money borrowed for purchasing of shares.

(ii) Expenditure of ₹20,000 incurred for purchase of lottery tickets.

(iii) An expenditure of ₹40000 incurred for the activity of owning and maintaining race horses. (2 marks each)

(b) Mr. Sahu, a Government employee and citizen of India, was sent to London on Official duty, on 01-06-2011. He stayed there upto 31-01-2012. The salary and allowance drawn by him during this period are given below:
4 months salary in India ₹2,00,000
8 months salary in London ₹3,60,000
Overseas allowance ₹2,40,000
Free residence in London (Rent ₹40,000 per month for 8 months) ₹3,20,000

He has a house property situated in Delhi which is self-occupied. During his stay in London his wife and children were staying in this property throughout the previous year. The fair rental value of the house is ₹56,000. He has paid ₹6,000 as municipal taxes and ₹2,000 as ground rent during the year.

He received dividend from an Indian company amounting to ₹2,200.

He has donated a sum of ₹60,000 to an institution to which section 80G is applicable.

Compute his Total Income for the assessment year 2012-13. (7 marks)

(c) What is Alternate Minimum Tax? (2 marks)

4. (a) Discuss the provisions regarding deductions allowable to an assessee in respect of the following:
    (i) Expenditure on treatment of a dependent being a person with disability. (5 marks each)
    (ii) Payment of interest on loan for higher education. (5 marks each)

(b) Briefly explain and illustrate how the tax liability of an assessee is determined with reference to residence. (5 marks)

Part B

5. (a) Re-write the following sentences after filling up the blank spaces with appropriate word(s)/figure(s):
    (i) At present, service tax is levied under the Union Government’s power to tax vide Entry 97 of List I of Schedule VII to the Constitution of India.
    (ii) A provider of service tax whose aggregate value of taxable service in a financial year exceeds ₹8 lakhs shall make an application for registration.
    (iii) Every assessee shall submit a return in Form ST-3.
    (iv) Taxable service of aggregate value of ₹10 lakh is exempt from the service tax leviable under section 66.
    (v) The provisions of service tax extend to whole of India. (1 mark each)

(b) How excess payment of service tax can be adjusted? And what are conditions to be satisfied for adjustment of excess service tax. (5 marks)

(c) How point of taxation is determined under Point of Taxation Rules, 2011. (5 marks)

(d) What are the due dates for filing of service tax return? (5 marks)
6. (a) Write Short Notes on:
   (i) Registration procedure
   (ii) Rates of taxes under VAT. \( (5\) marks each) \n
   (b) “Tax credit or invoice method has been adopted universally because of the inherent advantages in the credit method of calculating tax liability” Explain. \( (5\) marks) \n
   (c) State, with reasons in brief, whether the following statements are correct or incorrect.
      (i) VAT helps in checking tax evasion and in achieving neutrality.
      (ii) Exempt Sale means that the tax payable on sale of a commodity is fixed at 0%.
      (iii) As a result of introduction of VAT, the central sales tax has been phased out.
      (iv) Under Tax credit method rate of tax applied to the difference between value of output and cost of input.
      (v) Input tax credit is available in respect of goods purchased for manufacture of exempt goods. \( (1\) mark each)
EXECUTIVE PROGRAMME
TAX LAWS

QUESTION PAPERS OF PREVIOUS SESSIONS

Question papers of immediate past two examinations of Tax Laws paper are appended to this study material for reference of the students to familiarize with the pattern and its structure. Students may please note that answers to these questions should not be sent to the Institute for evaluation.

JUNE 2011

Time allowed : 3 hours               Maximum marks : 100

NOTE : All references to sections mentioned in Part-A of the Question Paper relate to the Income-tax Act, 1961 and the relevant Assessment Year 2011-12 unless stated otherwise.

PART — A
(Answer Question No.1 which is compulsory and any three of the rest from this part.)

1. (a) Write the most appropriate answer from the given options in respect of following having regard to the provisions of the relevant direct tax laws:

   (i) The maximum amount of deduction under section 80GG in respect of rent paid is —
   (a) `2,000
   (b) `3,000
   (c) `5,000
   (d) `10,000.

   (ii) Mohan Ltd. purchased goods on credit from Sohan Ltd. on 6th May, 2010 for `86,000 which is paid as `15,000 in cash on 11th May, 2010; `30,000 by a bearer cheque on 31st May, 2010; and `41,000 by an account payee cheque on 16th May, 2010. The amount of disallowance under section 40A(3) is —
   (a) `15,000
   (b) `30,000

   (c) `41,000
   (d) `50,000.
(c) ₹41,000
(d) ₹86,000.

(iii) Which of the following income is not included in the term ‘income’ under the Income-tax Act, 1961 —
(a) Profit and gains
(b) Dividend
(c) Profit in lieu of salary
(d) Reimbursement of travelling expenses.

(iv) Which of the following income is an agricultural income —
(a) Income from brick making
(b) Income from agriculture land situated in Pakistan
(c) Prize from government on account of higher crop yield
(d) Compensation received from insurance company on account of loss of crop.

(v) The maximum exemption under section 10(10AA) in case of leave encashment is —
(a) ₹3,50,000
(b) ₹3,00,000
(c) ₹10,00,000
(d) ₹5,00,000. (1 mark each)

(b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) Belated return of income may be filed within ________ from the end of the relevant assessment year.

(ii) A person, carrying on profession, has to get his accounts audited on compulsory basis if his gross receipts in profession for the previous year relevant to the assessment year 2011-12 exceeds ________.

(iii) The amount of tax payable by the assessee and the amount of refund due, under the provisions of the Income-tax Act, 1961 shall be rounded-off to the nearest ________.

(iv) The balance of income after deductions admissible under section 80C to 80U is called ________.

(v) Under section 44AB, specified date means ________ of the assessment year. (1 mark each)

(c) Goldie Ltd. has advanced an interest free loan of ₹5,00,000 to its employee Ramesh for purchase of car on 1st May, 2010. Ramesh has been regularly repaying the loan in installments of ₹20,000 per month at the end of each month.

Compute the value of perquisite on account of interest assuming that SBI rate of interest for such loan as on 1st April, 2010 is 10% per annum.
2. (a) State, with reasons in brief, whether the following statements are true or false:

(i) Unabsorbed depreciation can be carried forward for a maximum period of eight assessment years.

(ii) Speculation losses may be set-off against non speculative profits.

(iii) Expenses of purchasing lottery tickets are deducted out of winnings from lottery under the head income from other sources.

(iv) Zero-coupon bonds shall be treated as ‘short-term capital asset’ if held for more than 12 months but not more than 36 months.

(v) The income of minor child will always be included in the income of his/her parents.

(b) From the following information, compute the total income of Anurag for the assessment year 2011-12 and calculate his tax liability assuming he is not allowed any deduction under sections 80C to 80U:

Income from salary  1,80,000
Income from house property  40,000
Business loss  (–) 1,90,000
Loss from a specified business referred to under section 35AD (–) 60,000
Short-term capital loss (–) 60,000
Long-term capital gains  2,40,000

3. (a) After serving for 29 years and 7 months in Mansha Steels Ltd., Narayan retired on 30th September 2010. He is covered by the Payment of Gratuity Act, 1972. The company has paid him a gratuity of ₹4,19,800. At the time of retirement, he was getting basic salary ₹11,800, dearness allowance ₹2,260 and house rent allowance ₹1,400 per month. Determine the amount of gratuity exempt under section 10(10).

(b) Mrs. Sarita is an ordinary resident and citizen of India. The particulars of her assets and liabilities as on 31st March, 2011 are as follows:

(i) House property at Indore (three-fourths is self-occupied and one-forth is let-out) 16,80,000
(ii) Fixed deposit in a nationalised bank 2,00,000
(iii) Fixed deposit for five years in a chit fund 1,60,000
(iv) Agricultural land in Rajasthan ₹6,00,000 and tractor with other agricultural equipments 10,47,300
(v) Loan from bank for purchasing tractor 2,00,000
(vi) Two cars (valuation of small car ₹2,00,000; and big car : ₹12,87,000) 14,87,000
(vii) Ornaments (received by her in heritage) 13,60,000
(viii) Share application money  
(ix) Cash in hand  
(x) Ornaments with her minor son, Sandeep. (These were given to him by his grandfather.)

Compute the net wealth and wealth-tax payable by Mrs. Sarita for the assessment year 2011-12.  

(c) Rakshit whose house property was compulsorily acquired in the year 2005 received enhanced compensation of ₹9,00,000 on 15th November, 2010 which includes ₹2,40,000 as interest on such enhanced compensation. Discuss the taxability of such compensation.

4. (a) For the assessment year 2011-12, Hari is a non-resident in India. From the information given below, find out his income chargeable to tax for the assessment year 2011-12:

(i) Royalty received by him outside India from the Government of India: ₹17,000.
(ii) Technical fees received from an Indian company in Germany for advice given by him in respect of a project situated in Iran: ₹1,17,000.
(iii) Income from a business situated in Sri Lanka (goods are sold in Sri Lanka, sale consideration is received in Sri Lanka but business is partly controlled in Sri Lanka and partly in India): ₹2,17,000.
(iv) Income received in Nepal from a business connection in India: ₹3,17,000.
(v) Gift in foreign currency from a friend received in India on 20th January, 2011 : ₹80,000.
(vi) Past untaxed profit of 2000-01 brought in India on 10th April, 2010: ₹27,000.

(b) Distinguish between any three of the following:

(i) ‘Cost of acquisition’ and ‘cost of improvement’.
(ii) ‘Slab rate’ and ‘flat rate’ of income-tax.
(iii) ‘Short-term capital gains’ and ‘long-term capital gains’.
(iv) ‘Belated return of income’ and ‘revised return of income’.
(v) ‘Summary assessment’ and ‘scrutiny assessment’.

5. (a) Write short notes on any three of the following:

(i) Amortisation of telecom licence fee
(ii) Consequences of failure to deduct tax at source
(iii) Assessment in case of dissolution of an association of persons
(iv) Self-assessment
(v) Valuation of jewellery under the Wealth-tax Act, 1957.
(b) Ms. Rajni who draws a salary of ₹20,000 per month received the following gifts on or after 1st October, 2010 during the year 2010-11:

(i) Gift of ₹5,00,000 on 16th October, 2010 from a friend.

(ii) Gift of jewellery, fair market value of which is ₹3,00,000 on 17th October, 2010 from her fiancée.

(iii) Gifts of ₹51,000 each received from her four friends on the occasion of her marriage on 21st October, 2010.

(iv) Gift of ₹1,00,000 on 22nd November, 2010 from her mother’s sister.

(v) Gift of ₹60,000 on 25th November, 2010 from her father’s brother.

(vi) Gift of ₹50,000 on 1st December, 2010 from her husband’s friend.

(vii) Gift of ₹21,000 on 15th December, 2010 from her mother’s friend.

(viii) Gift of ₹26,000 on 25th December, 2010 from her brother’s father-in-law.

(ix) Gift of ₹1,21,000 from her husband’s brother.

(x) Gift of ₹26,000 from her employer.

(xi) Scholarship of ₹1,20,000 from a charitable institution registered under section 12AA.

(xii) She has purchased an immovable property from Bhawna who is not her relative for a sum of ₹24,50,000. The stamp duty value of the property is ₹26,00,000.

(xiii) She purchased bullion for ₹4,40,000 whose fair market value is ₹4,85,000.

Compute her total income for the assessment year 2011-12. 

(6 marks)

6. (a) Describe the provisions relating to chargeability of unexplained investment not recorded in the books of account. (4 marks)

(b) “If an individual writes a book, he shall be allowed deduction from his gross total income.” Explain the statement. (4 marks)

(c) On 31st December, 1980, Goverdhan purchased a plot for ₹40,000. The fair market value of the plot on 1st April, 1981 was ₹97,800. On 15th October, 2010, Goverdhan sells the plot for ₹14,30,000 and paid brokerage, etc., @2% on sales consideration. He invested ₹6,87,000 in the construction of residential house which was completed before 31st May, 2011.

Compute the taxable amount of capital gains for the assessment year 2011-12 of Goverdhan assuming that he already owns one residential house on the date of transfer of plot. Cost inflation index for the financial year 2010-11 is 711. (7 marks)
PART — B

7. Attempt any four of the following:

(i) Discuss ‘advance ruling’ in service tax. (5 marks)

(ii) Discuss briefly the procedure for registration of service tax provider. (5 marks)

(iii) What is the due date for payment of service tax? What is the rate of interest for delayed payment and penalty for default in payment of service tax? (5 marks)

(iv) What do you mean by ‘taxable services’ in the context of service tax? How is the value of taxable services determined? (5 marks)

(v) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):
   (a) Service tax in India made a humble beginning from ___________ with only three services.

   (b) Currently, the rate of service tax is ___________ (including education cess and secondary and higher education cess).

   (c) Every provider of taxable services whose aggregate value of taxable services in a financial year exceeds _____________, must mandatorily obtain registration.

   (d) The provision of service tax extends to whole of India except _____________.

   (e) Every assessee shall submit the half yearly return by the _____________ of the month following the particular half-year. (1 mark each)

PART — C

8. Attempt any four of the following:

(i) Who is liable to pay value added tax (VAT)? Discuss, in brief, the advantages of introduction of VAT in India. (5 marks)

(ii) What are the methods of computation of VAT? (5 marks)

(iii) What is input VAT credit? Will the input VAT credit be available in case of purchase of capital goods? (5 marks)

(iv) Compute the VAT liability of Anand for the month of October, 2010 using the invoice method of computation of VAT:

   - Purchases from the local market (including VAT @ 4%): ₹65,000.
   - Storage cost incurred: ₹750.
   - Transport cost: ₹1,750.

   Goods sold at a margin of 5% on the cost of such goods. VAT rate of sales is 4%. (5 marks)
(v) State, with reasons in brief, whether the following statements are true or false:

(a) Under zero-rated sales, prior stage tax is set-off against the zero per cent tax paid, and effectively the entire tax paid on purchases is eligible for refund.

(b) A special VAT rate of 2% is prescribed for precious and semi-precious metals.

(c) Tax cannot be evaded under VAT system.

(d) There are certain cases of purchases in respect of which generally no input tax credit is available.

(e) Input VAT credit is available on inter-State purchases.  

(1 mark each)
PART — A

(Answer Question No. 1 which is compulsory and ANY THREE of the rest from this part.)

1. (a) Write the most appropriate answer from the given options in respect of following having regard to the provisions of the relevant direct tax laws:

   (i) Which of the following income is not exempt under section 10 —
       (a) Share in total income of firm
       (b) Income from agriculture in Lahore
       (c) Bonus on life insurance
       (d) Income from mutual funds.

   (ii) Which of the following income is taxable under the head ‘income from salary’ —
       (a) Salary received by a partner from firm
       (b) Salary received by a Member of Parliament
       (c) Salary of a Government Officer
       (d) None of the above.

   (iii) Rate of depreciation chargeable on fully temporary wooden structure for the assessment year 2011-12 is —
       (a) 5%
       (b) 10%
       (c) 100%
       (d) None of the above.

   (iv) When the income of an individual includes ₹20,000 as the income of his minor child in terms of section 64(1A), taxable income in this respect will be —
       (a) Nil
       (b) ₹20,000
       (c) ₹18,500
       (d) None of the above.

   (v) Deduction available to an individual in respect of maintenance including medical treatment of a dependent being a person with 80% disability, when amount incurred in this respect is ₹40,000 will be —
       (a) ₹40,000
(b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) The residential status of an assessee is determined for the relevant ____________.

(ii) For the purposes of clubbing of income of the specified person in the income of the individual under section 64, the word ‘income’ includes ______________.

(iii) Deduction available under section 80QOB in respect of royalty income of authors shall not exceed ₹ ____________ in a previous year.

(iv) Rent received by original tenant from sub-tenant is taxable under the head ____________.

(v) Commissioner of Income-tax is appointed by ______________.

(c) What are the requisites for filing a revised return under the Income-tax Act, 1961?

2. (a) State, with reasons in brief, whether the following statements are true or false:

(i) Prize given to Suresh by the Government of Madhya Pradesh on account of higher crop yield is an agricultural income.

(ii) Voluntary contribution received by electoral trust shall be exempt in all cases.

(iii) Sandeep Ltd. is a company registered in Japan. The control and management of its affairs is wholly situated in India. Sandeep Ltd. is non-resident company in India.

(iv) The Commissioner (Appeals) may confirm, reduce or enhance the amount of tax assessed by the Assessing Officer.

(v) A partnership firm incurring loss need not to file return of income.

(b) Vinod sells the following assets on 10th January, 2011:

<table>
<thead>
<tr>
<th>Asset Description</th>
<th>Sales Consideration</th>
<th>Cost of Acquisition</th>
<th>Transfer Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Shares in R Ltd.</td>
<td>6,00,000</td>
<td>40,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Jewellery</td>
<td>7,50,000</td>
<td>80,000</td>
<td>—</td>
</tr>
<tr>
<td>Plot of Land (Self-generated)</td>
<td>25,00,000</td>
<td>2,50,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Goodwill of a Business</td>
<td>25,00,000</td>
<td>Nil</td>
<td>—</td>
</tr>
<tr>
<td>Date of Acquisition</td>
<td>04.05.1988</td>
<td>04.03.1996</td>
<td>04.02.1991</td>
</tr>
</tbody>
</table>
Based on the following indices, compute income from capital gains of Vinod for the assessment year 2011-12 taking into consideration the facts that the business was set-up in November, 1997 and that he purchased a plot of land for ₹8,00,000 and jewellery for ₹2,00,000 on 10th March, 2011.


3. (a) Adarsh, a Member of Parliament (MP) from Uttar Pradesh, submits the particulars of his income for the assessment year 2011-12. Compute his income from other sources:

(i) Salary as MP ₹4,60,000
(ii) Daily allowances as MP ₹1,80,000
(iii) Dividend received from a domestic company ₹60,000
(iv) Winnings from horse race (Gross) ₹40,000
(v) Winnings from Sikkim State lotteries received (Net) ₹70,000
(vi) Agricultural income in Sri Lanka ₹4,00,000

He received a royalty of ₹1,00,000 from a book of stories written by him. He claimed ₹12,000 as expenditure on stationery and typing.

He let-out one of his buildings alongwith plant, machinery and furniture for ₹50,000 per month. He claimed the following expenses as deduction for this building — insurance : ₹10,000; repairs : ₹15,000; depreciation : ₹40,000.

Interest credited to his recurring deposit account and cumulative time deposit account in post office were ₹32,000 and ₹48,000 respectively.

(b) Narayan had to pay ₹1,13,300 as advance tax during the financial year 2010-11. He has deposited the amount of advance tax as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>15.09.2010</td>
<td>29,760</td>
</tr>
<tr>
<td>15.12.2010</td>
<td>36,400</td>
</tr>
<tr>
<td>15.03.2011</td>
<td>47,140</td>
</tr>
</tbody>
</table>

Is he liable to pay any interest under section 234C? If yes, determine the amount of interest payable by him.

(c) Describe the provisions relating to chargeability of cash credits in respect of which the assessee has no satisfactory explanation.

4. (a) Distinguish between any three of the following:

(i) ‘Gross total income’ and ‘total income’.
(ii) ‘Allowances’ and ‘perquisites’.
(iii) ‘Active user of asset’ and ‘passive user of asset’.
(iv) ‘Exemption under section 54G’ and ‘exemption under section 54GA’. 
(v) ‘Statutory provident fund’ and ‘public provident fund’. 

(3 marks each)

(b) Mrs. Suman provides you following information regarding assets and liabilities owned by her on 31st March, 2011:

<table>
<thead>
<tr>
<th>Market Value</th>
<th>(`)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Residential house (self-occupied)</td>
<td>50,00,000</td>
</tr>
<tr>
<td>(ii) Loan taken for purchase of self-occupied house</td>
<td>10,00,000</td>
</tr>
<tr>
<td>(iii) Motor car for business use</td>
<td>10,00,000</td>
</tr>
<tr>
<td>(iv) Land in urban area</td>
<td>35,00,000</td>
</tr>
<tr>
<td>(v) Loan taken to purchase above land</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(vi) Cash in hand</td>
<td>1,25,000</td>
</tr>
<tr>
<td>(vii) Cash at bank</td>
<td>2,00,000</td>
</tr>
<tr>
<td>(viii) Land in rural area within 5 kms. from Delhi</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(ix) Jewellery</td>
<td>14,80,000</td>
</tr>
<tr>
<td>(x) Farm house situated outside 30 kms. from local limits of municipality</td>
<td>40,00,000</td>
</tr>
<tr>
<td>(xi) One residential house given on rent for 330 days during the previous year</td>
<td>35,00,000</td>
</tr>
<tr>
<td>(xii) Loan taken for construction of above house</td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

Compute net wealth and wealth-tax liability of Mrs. Suman for the assessment year 2011-12. 

(6 marks)

5. (a) Write short notes on any three of the following:

(i) Deduction in respect of interest on loan taken for higher education.

(ii) Treatment of agricultural income for tax purposes.

(iii) Circumstances in which best judgment assessment is made by the assessing officer.

(iv) Consequences of failure to deduct tax at source.

(v) Assets exempt from tax as per section 5 of the Wealth-tax Act, 1957. 

(3 marks each)

(b) Anurag owns three houses, the particulars of which are given below:

<table>
<thead>
<tr>
<th>House-A (`)</th>
<th>House-B (`)</th>
<th>House-C (`)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal value</td>
<td>80,000</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Fair rent</td>
<td>90,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Monthly rent</td>
<td>8,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Rent collection charges</td>
<td>8,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Repair expenses</td>
<td>5,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Interest on loan :</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– For construction</td>
<td>40,000</td>
<td>—</td>
</tr>
<tr>
<td>– For marriage of son</td>
<td>—</td>
<td>30,000</td>
</tr>
<tr>
<td>– For repairs</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>
Commencement of construction  04.04.2003  04.01.2005  04.07.2006
Completion of construction  31.03.2007  30.06.2007  31.12.2008
Use by tenant    Residential  Office   Residential

Municipal tax is charged @ 10%. Anurag paid municipal tax of House-A but did not pay municipal tax of House-B. The tenant paid the municipal tax of House-C which remained vacant for 3 months.

Compute income from house property of Anurag for the assessment year 2011-12. 

6. (a) Mahender is the karta of a Hindu Undivided Family (HUF). Compute the taxable income of the family and amount of tax payable by it on the basis of the following particulars for the year ended 31st March, 2011:

(i) Income from house property: The family uses its ancestral house for residence; the municipal value of the house is ₹60,000 per annum and interest on loan borrowed for the house has accrued to the tune of ₹22,000.

The family owns another house which is let-out for ₹8,000 p.m. The family made payment in respect of municipal taxes for the three previous years 2008-09 to 2010-11 during the current previous year 2010-11 itself equal to ₹12,000 for the let-out house.

(ii) Income from family business: Net income of the family business after charging salary amounting to ₹1,20,000 of karta is ₹4,00,000.

It also incurred/earned the following items of losses, expenses and incomes:

<table>
<thead>
<tr>
<th>Item</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss on horse race</td>
<td>4,000</td>
</tr>
<tr>
<td>Winnings from lotteries</td>
<td>20,000</td>
</tr>
<tr>
<td>Profit on speculation in silver</td>
<td>18,000</td>
</tr>
<tr>
<td>Loss on speculation in gold</td>
<td>6,000</td>
</tr>
<tr>
<td>Life insurance premium on the life of family members</td>
<td>12,000</td>
</tr>
<tr>
<td>Donation to National Defence Fund</td>
<td>10,000</td>
</tr>
<tr>
<td>Donation to other approved bodies</td>
<td>50,000</td>
</tr>
</tbody>
</table>

(iii) Income from other sources:

<table>
<thead>
<tr>
<th>Item</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on maturity of NSCs, VIII Issue</td>
<td>12,500</td>
</tr>
<tr>
<td>Dividend received from an Indian company (Gross)</td>
<td>15,000</td>
</tr>
<tr>
<td>Collection charges paid for dividend</td>
<td>400</td>
</tr>
</tbody>
</table>

(b) Discuss the procedure of regular assessment under the Income-tax Act, 1961.

(5 marks)

7. Attempt any four of the following:

(i) What are the various provisions relating to payment of service tax? Explain. (5 marks)

(ii) What are the provisions regarding penalties under service tax in the
following cases:
(a) Failure to take registration.
(b) Failure to keep books of account.
(c) Failure to produce accounts and documents.  

(iii) “The value of any taxable service shall be the gross amount charged by the service provider for such service rendered by him”. In the light of this statement, explain how the value of taxable service is determined.  

(iv) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):
(a) Rate of service tax payable for the financial year 2010-11 is _____ per cent.
(b) Maximum amount of penalty for late filing of service tax return is ₹_____.
(c) Under service tax rules, every assessee is required to furnish to _____ at the time of filing his return for the first time a list of all accounts maintained in relation to the service tax.
(d) Service tax in India is levied by ______.
(e) Service tax return can be revised within a period of ______ from the date of submission of return.  

(v) State, with reasons in brief, whether the following statements are true or false:
(a) Service tax in India is levied under a separate enactment.
(b) The Central Excise Officer is empowered to impose penalty under service tax.
(c) The Central Government has exempted some of the taxable services.
(d) Recovery and adjustment of service tax means the same thing.
(e) Service tax is administered by service tax department.  

PART—C

8. Attempt any four of the following:

(i) What is ‘white paper’? What are the different parts of white paper under value added tax (VAT)?
(ii) Explain the procedure of computation of VAT liability of a dealer.
(iii) Write a note on certification by professionals under VAT system.
(iv) Explain the audit procedure applicable under the VAT system.
(v) “Input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax.”  Explain.