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TAXATION LAWS

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INTRODUCTION

– Income tax is one of the form of Direct Taxes. Tax is the financial charge imposed by the Government on income, commodity or activity. Government imposes two types of taxes namely Direct taxes and Indirect taxes. Direct tax is one where burden of tax is directly on the payer e.g income tax, wealth tax etc.

Indirect tax is paid by the person other than the person who utilizes the product or service e.g Excise duty, Custom duty, Service tax, Sales Tax, Value Added Tax.

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

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

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

– The Income tax Act contains the provisions for determination of taxable income, determination of tax liability, procedure for assessment,

appeal, penalties and prosecutions. It also lays down the powers and duties of various income tax authorities.

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

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

– Circulars: Circulars also issued by the CBDT to clarify the doubts regarding the scope and meaning of the provisions. These provisions are issued for the guidance of the Income Tax officers and assesses.

These circulars are binding on the department, not on the assessee but assessee can take benefit of
these circulars.

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

BASIC CONCEPTS OF INCOME TAX ACT

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

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

INCOME

No precise definition of the word 'Income' is attempted under the Income-tax Act, 1961. The definition of Income as given in Section 2(24) of the Act starts with the word includes therefore the list is inclusive not exhaustive. The definition enumerates certain items, including those which cannot ordinarily be considered as income but are treated statutorily as such. Income includes not only those things which the interpretation clause declares. It shall also include all such things the word signifies according to its natural import. Entry 82 of List I to the Seventh Schedule of the Constitution of India confers power on Parliament to levy taxes on income other than agricultural income.

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

1. Profits and gains;
2. Dividend;
3. Voluntary contributions: Voluntary contributions received by :

– a trust created wholly or partly for charitable or religious purposes

– a scientific research association; or

– a fund or trust or institution established for charitable purposes and notified under section 10(23C)(iv) or (v) or

– any university or other educational institution or by any hospital referred to in Section 10(23C)(iiad)(vi)(iiiae)(iva); or

– An electoral trust.
4. The value of any perquisite or profit in lieu of salary taxable.
5. Any special allowance or benefit specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
6. City Compensatory Allowance/ Dearness allowance: Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
7. Benefit or Perquisite to a Director: The value of any benefit or perquisite, whether convertible into
money or not, obtained from a company by: (a) a director, or (b) a person having substantial interest in the company, or (c) a relative of the director or of the person having substantial interest, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;
8. Any Benefit or perquisite to a Representative Assessee: the value of any benefit or perquisite (whether convertible into money or not) obtained by any representative assessee under Section 160(1)(iii)/(iv) or beneficiary, or any amount paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;
9. Any sum chargeable under section 28, 41 and 59 :
– Any sum chargeable to tax as business income under Section 28(ii), any amount taxable in the hands of a trade, professional or similar association (for specific services performed for its members) as its income from business under Section 28(iii), and deemed profits which are taxable under Sections 41 and 59 of the Act;
– Any sum chargeable to income-tax under clause (iiia) of Section 28, i.e. profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 [inserted by the Finance Act, 1990, with retrospective effect from 1.4.1962];
– any sum chargeable to income-tax under clause (iiib) of Section 28 i.e., cash assistance (by whatever name called), received or receivable by any person against exports under any scheme of the Government of India.
– any sum chargeable to income-tax under clause (iiic) of Section 28 i.e., any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971.
– the value of any benefit or perquisite whether convertible into money or not; taxable as income under Section 28(iv) in the case of person carrying on business or exercising a profession;
– any sum chargeable to income-tax under clause (v) of Section 28;
10. Capital Gain: Any capital gains chargeable to tax under Section 45; since the definition of income in Section 2(24) is inclusive and not exhaustive capital gains chargeable under Section 46(2) are also assessable as income.
11. Insurance Profit: The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society

computed in accordance with the provisions of Section 44 or any surplus taken to be such profits and gains by virtue of the profits contained in the First Schedule to the Income-tax Act;

12. Banking income of a Co-operative Society: The profits and gains of any business of banking (including) providing credit facilities carried on by a cooperative society with its members.

13. Winnings from Lottery: Any winnings from lotteries, crossword puzzles, races, including horse-races, card-games and games of any sort or from gambling or betting of any form.

(i) "lottery" includes winnings, from prizes awarded to any person by draw of lots or by chance or in

any other manner whatsoever, under any scheme or arrangement by whatever name called;

(ii) "card game and other game of any sort" includes any game show, an entertainment programme on

television or electronic mode, in which people compete to win prizes or any other similar game;

14. Employees Contribution Towards Provident Fund: Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set-up under the provisions of the Employees State Insurance Act, 1948 (34 of 1948) or any other fund for the welfare of such employees. 15. Amount Received under Keyman Insurance Policy: Any sum received under a Keyman Insurance Policy including the sum allocated by way of bonus on such policy. Keyman Insurance Policy means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected with the business of the first mentioned person in any manner whatsoever.

16. Amount received for not carrying out any activity: Any sum referred to in Section 28(va), i.e. any sum, whether received or receivable in cash or kind, under an agreement for –

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

(ii) not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services:

17. Gift received for an amount exceeding ` 50,000: Any sum of money or value of property referred to in clause (vii) or clause (viia) of sub-section (2) of Section 56.

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

Concept of Income

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

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

1. Cash or kind

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

2. Receipt basis/ Accrual basis

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

3. Legal or illegal source

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

4. Temporary/Permanent

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

5. Lumpsum/instalments

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

6. Gifts

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

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

CAPITAL AND REVENUE RECEIPTS

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

Type of Capital

1. Fixed capital

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

2. Circulating Capital

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

Type of capital will depend upon the nature of business

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

Nature of receipt also depends upon the reference to the recipient

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

Example

– The reimbursement of capital outlay is a capital receipt even if the total amount received exceeds the cost of the outlay itself.

– Compensation received for the loss of a capital asset is a receipt of a capital nature whereas the
compensation received for damage to or loss of a trading asset is a revenue receipt.

– A capital asset is converted into income and the price realized on its sale takes form of the periodic
payments of a revenue nature;

– Where a person sells his properties and the sale price is payable to him by the purchaser in the form of annuities of a fixed sum so long as the seller is alive or until he attains a particular age.

Capital and Revenue Receipts In Relation To Business Activities

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

Examples of these type of receipts are:

– profits on purchase and sale of shares by a share broker on his own account;

– profits arising from dealings in foreign exchange by a banker or other financial institutions,

– income from letting out buildings owned by a company to its employees etc.

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

For instance, profit on sale of shares and securities held by a bank as investments would be of a capital nature. Where profits arise from transactions which are outside the normal dealing of the assessee, although connected with his business, the taxable nature or otherwise of

the profits would depend upon the fact whether or not the transaction(s) in question constitute(s) trading activity.

Examples of differentiation between Revenue Receipts and Capital Receipts

1. Taxable income in relation to Annuities

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

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

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

2. Taxable income vis-a-vis Compensation

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

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

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

4. Taxable income vis-a-vis debenture

For debenture holder the premium on redemption or the discount on issue of the debentures by the company would be a capital receipt and would not consequently be liable to tax. In the case of the issuing company also, the premium or discount on the issues of shares and debentures or on their redemptions would be on capital account. But the discount on loans advanced at a discount and repayable at a premium would be a revenue receipt in the hands of a person whose business is that of money-lending if the loans had been advanced in the ordinary course of the assesses 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.

5. Taxable income vis-a-vis Royalties

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

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

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

Exceptions where capital receipt are taxable

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

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

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

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

Factors that do not determine the nature or character of receipt

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

(i) Character and source of income

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

(ii) Application of income

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

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

The payment may represent expenditure in the hands of the payer and in certain cases may be disallowed in computing the taxable income of the payer. But the disallowance in the payer's hands would not in any way affect the taxability of the entire amount of remuneration in the employees or directors hands although there may be double taxation of

the same amount in two hands for the same period. Thus, the allowance or disallowance of the amount to the payer is immaterial for taxing the recipient.

(iv) Treatment given in the books

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

(v) Magnitude and method of payment

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

(vi) Basis for measurement of the receipt

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

(vii) Ways or devices resorted by payer

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

Illustration:

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

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

Solution

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.

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.

PERSON [SECTION 2(31)]

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

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

An individual

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

A Hindu undivided family

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

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

A company

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

A firm

a partnership firm whether registered or not.

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

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

A local authority

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

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

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

ASSESSMENT YEAR [SECTION 2(9)]

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

PREVIOUS YEAR (SECTION 3)

Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year. From the assessment year 1989-90 onwards, all assessees are required to follow financial year (i.e. April 1 to March 31) as previous year. The uniform previous year has to be followed for all sources of income. In case of newly set up business or profession or a source of income newly coming into existence, the first previous year will be the period commencing from the date of setting up of business/profession or as the case may be, the date on which the source of income newly comes into existence and ending on the immediately following March, 31.

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

Example 1

Y sets up a new business on May 15, 2013. What is the previous year for the assessment year 2014-15. Ans. Previous year for the assessment year 2014-15 is the period commencing on May 15, 2013 and ending on March 31, 2014.

Example 2

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

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

Previous year Assessment year

Feb. 17, 2013 to March 31, 2013 2013-14

April 1, 2013 to March 31, 2014 2014-15

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY OF AN ASSESSEE

Notes

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

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

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

TAX RATES

(A) For any individual (resident or non-resident), every HUF/AOP//BOI/artificial juridicial person Total Income From All Sources Except Incomes Taxable at Specified Income Tax Rates Rates (after All Permissible Deduction)

Upto 2,00,000 NIL
` 2,00,001 to ` 5,00,000 10%
` 5,00,001 to `10,00,000 20%
Above ` 10,00,000 30%

For resident senior citizen (who is of 60 years but less than 80 years during the previous year)

Upto ` 2,50,000 NIL
` 2,50,001 to ` 5,00,000 10%
` 5,00,001 to ` 10,00,000 20%
Above ` 10,00,000 30%

For resident senior citizen (who is of 80 years during the previous year) Upto ` 5,00,000 NIL
` 5,00,001 to ` 10,00,000 20%
Above ` 10,00,000 30%

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

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

(D) Cooperative Society

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

(E) Surcharge

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

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

– On Domestic company

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

– On companies other than domestic companies

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

(F) Education Cess and Secondary Higher Education Cess

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

(G) Alternate minimum Tax

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

REVIEW QUESTIONS

1. Distinguish between capital receipt and revenue receipt
2. Distinguish between total income and gross total income
3. 'Every assessee is a person, but every person need not be an assessee'. Critically examine the statement with reference to the relevant definitions under the provisions of the income tax act, 1951.
4. Distinguish between assessment year and previous year
5. "income tax is a tax on income and not a tax on every item of money received." Explain this statement with reference to capital and revenue receipts.
6. Distinguish between slab rate and fixed rate.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

IMPORTANT NOTES

UNIT-2 BASIS OF CHARGE, SCOPE OF TOTAL INCOME AND RESIDENTIAL STATUS

CONTENTS

- Residential Status and Tax Liability
- Test for residence of individuals
- Test for residence of HUF, Firms and other Associations of Persons
- Test for residence of companies
- Charge of Income Tax
- Meaning and Scope of total Income
- Scope of total income has been defined on the basis of residential
- status
- Income received
- Income deemed to be received
- Income accrued
- Income deemed to accrue or arise in India
- Apportionment of Income between spouses governed by Portuguese Civil Code
- Tax incident vis-a-vis residential status
- Review Questions
- Further Readings

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

RESIDENTIAL STATUS AND TAX LIABILITY (SECTION 6)

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

(i) Resident in India or

(ii) Non-resident in India

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

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

(b) Resident but not Ordinarily resident in India (RNOR).

In case of persons other than individual and HUF, he will be either resident in India or non-resident in India. Section 6 of the Income-tax Act prescribes the tests to be applied to determine the residential status

of all tax payers for purposes of income-tax. There are three alternative tests to be applied for individuals, two for companies and Hindu Undivided Families and firms, associations of persons, bodies of individuals and artificial juridical persons. An assessee's residential status must be determined with reference to the previous year in respect of which the income is sought to be taxed (and not with reference to the assessment year).

TEST FOR RESIDENCE OF INDIVIDUALS

An individual may either be a
(i) Resident in India or
(ii) Non-resident in India

However, individual cannot be simply called resident in India. If individual is a resident in India he will be either; (a) Resident and Ordinarily resident in India (ROR) or (b) Resident but not Ordinarily resident in India (RNOR).

Basic Condition for a person to be Resident

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

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

(b) has been in India for at least three hundred and sixty-five days (365 days) during the four years preceding the previous year and has been in India for at least sixty days (60 days) during the previous year except in following cases; where if condition (a) is satisfied then an individual is resident otherwise he will be Non-Resident.

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

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

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

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

Non-Resident

If an individual does not satisfy any of the above basic condition then, he will be treated as Non-Resident. It must be noted that the fulfillment of any one of the above conditions (a) or (b) will make an individual resident in India for tax purposes since both these conditions are alternative and not cumulative in their application

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

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

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

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

Resident and not ordinary resident (RNOR)

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

Important Points

(i) The fact that an assessee is resident in India in respect of one year does not automatically mean that he would be resident in the preceding or succeeding years as well. Consequently, the residential status of the assessee should be determined for each year separately. This is in view of the fact that a person resident in one year may become non-resident or not ordinarily resident in another year and vice versa.

(ii) It must also be noted that the residential status of an individual for tax purposes is neither based upon nor determined by his citizenship, nationality and place of birth or domicile. This is because of the fact that, for tax purposes, an individual may be resident in more than one country in respect of the same year.

(iii) The common feature in both the above conditions is the stay of the individual in India for a specified period.

The period of stay required in each of the conditions need not necessarily be continuous or consecutive nor it is stipulated that the stay should be at the usual place of residence, business or employment of the individual.

Purpose of stay is immaterial in determining the residential status.

(iv) The stay may be anywhere in India and for any length of time at each place in cases where the stay in India is at more places than one, what is required is the total period of stay should not be less than the number of days specified in each condition.

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

– Step 1: Determine whether the person falls under exception to basic condition;

– Step 2: If yes, apply only first basic condition, if satisfied, then he will be resident otherwise non-resident.

If no, then apply both basic conditions and Individual becomes Resident on satisfaction of any one
condition.

– Step 3: Resident Individual will be called ROR if satisfies both the additional conditions, otherwise he will be called RNOR.

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

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

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

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

Meaning of place of control and management:

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

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

– Control and Management of HUF: It is with Karta or its Manager.

– Control and Management of Firm/AOP: It is with Partners/Members.

– Control and Management of Company: It is with Board of Directors. It can be said that Control and

Management of Company is situated at a place where Board meetings are held.

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

A HUF can be "not ordinarily resident"

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

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

Additional Conditions :

(1) Karta of Resident HUF should be resident in atleast 2 previous years out of 10 previous year immediately preceding relevant previous year.
(2) Stay of Karta during 7 previous year immediately preceding relevant previous year should be 730 days or more.
Note:
It is immaterial whether Karta is Resident or Non-Resident during relevant previous year, for the purpose of determining whether HUF is ROR or RNOR. If Karta satisfies both the additional conditions, then HUF will be ROR, otherwise RNOR.
Firms, association of persons, local authorities and other artificial juridical persons can be either resident (ordinarily resident) or non-resident in India but they cannot be not ordinarily resident in India.

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.

CHARGE OF INCOME-TAX (SECTION 4)

Section 4 of the Act is the charging section. A section in a Act, which imposes a charge is referred to as a charging section and a section merely providing rules for working out the charge so imposed is referred to as a machinery section. It lays down the basis on which tax is imposed.
Accordingly, this section provides that:
(a) income-tax shall be charged at the rate or rates prescribed in the Finance Act for the relevant previous year; (discussed in 1st Unit)
(b) the charge of tax is on various persons specified in Section 2(31) (definition of persons, discussed in 1st Unit);
(c) the income sought to be taxed is that of the previous year and not of the of assessment year; and (d) the levy of tax on the assessee is on his total or taxable income computed in accordance with and subject to the appropriate provisions of the Income-tax Act, including provisions for the levy of additional income-tax.
The assessment should, in every case, be made in accordance with the provisions of the law in force in the relevant assessment year and not the law applicable to the previous year.

Exceptions

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

However, there are five exception to this rule:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(e) Discontinued business (Section 176)

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

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

MEANING AND SCOPE OF TOTAL INCOME (SECTION 5)

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

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

(b) the exact place and point of time at which the accrual or receipt of income takes place, and

(c) the residential status of the assessee.

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

(A) Resident and Ordinarily Resident Assessee

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

(i) income received or deemed to be received in India during the accounting year by or on behalf of such person;

(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the accounting year;

(iii) income which accrues or arises to him outside India during the accounting year.

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

(B) Resident but Not Ordinarily Resident In India

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

(i) income received or deemed to be received in India during the accounting year by or on behalf of such person;

(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the accounting year;

(iii) income which accrues or arises to him outside India during the previous year if it is derived from a business controlled in or a profession set up in India.

(C) Non-Resident

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

(i) income received or deemed to be received in India in the accounting year by or on behalf of such person;

(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the previous year.

Income received

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

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

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

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

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

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

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

Place and date of receipt of income:

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

(i) Date of receipt when receipt is by cheque

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

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

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

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

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

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

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

(v) Payment by transfer of immovable property

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

(vi) Issuing receipt in advance

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

Income deemed to be received

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

(i) All sums deducted by way of taxes at source (Section 198).

(ii) Incomes of other persons which are included in the income of the assessee under Sections 60 to 64.

(iii) The amount of unexplained or unrecorded investments (Section 69).

(iv) The amount of unexplained or unrecorded moneys, etc. (Section 69A).

(v) The annual accretion in the previous year to the balance standing at the credit of an employee participating in a Recognised Provident fund to the extent provided in Rule 6 of Part A of the Fourth Schedule [Section 7(i)]. The contributions made by the employer to Recognised Provident Fund in excess of 12% of the employees salary and the interest credited to the Provident Fund account of the employee in excess of the prescribed rate i.e., 8.5% shall be included in the salary income of the employee. This amount is known as annual accretion.

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

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

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

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

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

tax on his world income and therefore this judgment affects a non-resident more than it affects a resident.

Income accrued

The accrual of income is different and distinct from the receipt of income discussed above. Sometimes in the context of accrual or arisal the word earned is used. A person may be said to have earned his income in the sense that he has contributed to the production by rendering of goods or services. But in order that the income may be said to have accrued to him, an additional element is necessary, that is, he must have created a debt in his favour. Income is said to accrue when it comes into existence for the first time or at the point of time when the right to receive the income arises although the right may be exercised or exercisable at a future date. Income is said to be received when it reaches the assessee. When the right to receive the income becomes vested in the assessee, it is said to accrue or arise. Income is said to accrue only to that person who is lawfully entitled to that income. Income accrues at the place where the source of the income is situated, which may or may not be the same as the place from which the business activities are carried on. Normally, income accrues at the place where the contract yielding the income is entered into and for this purpose the contract should be taken to have been entered into at the place where the offer is accepted.

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

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

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

Income deemed to accrue or arise in India

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

(a) Income by virtue of business connection

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

– For purposes of deeming income to accrue or arise in India, the expression 'business connection' must be taken to have wider scope 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 by 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 intosome form suitable for export outside India;

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

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

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

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

No Business connection in India in following cases of Non-Resident.
(1) Tax Exemption for encouraging Export :
– For the purpose of encouraging exports, a specific tax concession has been given by providing that no income shall be deemed to accrue or arise in India to a non-resident through or from his operations which are confined to the purchase of goods in India for the purpose of export.
– This exemption is available to a non- resident even though he keeps an office agency for the purpose of buying and export. This exemption is, however, not available to residents or not ordinarily residents.
– In order to qualify for tax exemption, it is essential that the operations of the non- residents, although arising from business connection, should be confined to the purchase of goods for the purpose of export outside India.
– Consequently, the exemption would not be available if the goods purchased in India are sold in India or are not exported outside India.
– Further, if the non-resident works up the raw-materials into finished or semi-finished products, the exemption would be withdrawn and he would become chargeable on such portion of the profits as is
attributable to his manufacturing it in India.
(2) Operations confined to collection of news and views for transmission outside India by or on behalf of Non- Resident who is engaged in the business of running news agency or of publishing newspapers, magazines or journals;
(3) Operations confined to shooting of cinematograph films in India if such Non-Resident is:
(a) an Individual – he should not be a citizen of India; or
(b) a firm – the firm should not have any partner who is a citizen of India or who is resident in India; or
(c) a company – the company does not have any shareholder who is a citizen of India or who is resident in India

(b) Income arising from any asset or property in India:
– Income arising in a foreign country from any property situated in India would be deemed to accrue or arise in India.
– In this context, the term property does not refer to house property alone but it refers to all tangible
properties whether movable or immovable. For instance, the rent or hire charges for the use of buildings or machinery of the assessee which, under an agreement are payable only outside India, would be deemed to accrue or arise in India.
– Income arising through or from any asset or source of income in India would also be deemed to accrue or arise in India.
– In this context, the term source means not a legal concept but something which a practical man would regard as a real source of income.
– The term property does not refer to the property dealt with by Sections 22 and 23, but it includes any tangible movable or immovable property. The term asset would, however, include all intangible rights and, consequently, interests, dividends, patents and copyrights, royalties, rents etc. will be assets.

(c) Capital asset:

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

(d) Income from salaries

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

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

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

(iii) A Non-Resident in India provided interest is payable in respect of moneys borrowed and used for a business or profession carried on in India (i.e. Interest payable by a Non-Resident for loan used for only business or profession in India)

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

(i) Government; or

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

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

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

(i) Government; or

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

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

(h) Taxability of Dividend :

– Dividend paid by any Indian company outside India is deemed to accrue or arise in India and the income is consequently chargeable to

income-tax irrespective of the fact whether the dividend is interim dividend or a final dividend and whether it is an actual dividend or a notional dividend.

– The place of declaration of the dividend is immaterial and the date of payment is equally immaterial for deeming the income to accrue in India.

– Normally, dividend income arises at the place where the source of income is situated, i.e., where the shares yielding the income are kept. Shares are said to be situated at the place where the share register of the company is kept. While the share register of a company should ordinarily be kept at the place where its registered office is located, even if the share register is kept outside India and the dividends are declared outside India, the dividend would still be deemed to accrue in India because the company

is an Indian company. It is another matter that dividend paid/payable by Indian companies has been exempted vide Section 10(34) with the introduction of the system of distribution tax which has shifted the incidence of tax on dividend to the company from the shareholder.

– Dividends declared by foreign companies outside India would not, however, be deemed to accrue or arise in India even in cases where the foreign company is resident in India because of the control and management of its affairs being situated wholly in India.

– In order to deem the dividend income as arising in India, the residential status of the shareholder as also the status of the assessee, whether he is an individual, company or local authority, are irrelevant.

REVIEW QUESTIONS

- Write a short notes taxability of income by virtue of business connection?
- Write a short notes income deemed to accrue or arise in India.
- Distinguish between resident and not ordinary resident.
- Write a short notes income deemed to accrue or arise in India.
- Distinguish between domestic company and foreign company.
- What are the different categories into which the assessees are divided regarding residence and how is the residence of assessees determined for income-tax purposes? Explain.
- Write a short notes income deemed to be received in India.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

UNIT-3 INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

CONTENTS

General Exemption

- Specific Exemption
- Exemptions for Charitable Trusts and Institutions
- Exemption for Political Parties
- Review Questions
- Further Readings

GENERAL EXEMPTION

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

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

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

AGRICULTURAL INCOME [SECTION 10(1)]

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

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

Definition of Agricultural Income

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

Agricultural income means –

(a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes;

(b) Any income derived from such land by –

(i) agriculture; or

(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or

(iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (ii) of this sub-clause ;

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

Provided that –

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

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

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

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

(I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten thousand but not exceeding one lakh; or

(II) not being more than six kilometres, from the local limits of any municipality or cantonment board
referred to in item (A) and which has a population of more than one lakh but not exceeding ten lakh; or

(III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten lakh.

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

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

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

Explanation 4. – For the purposes of clause (ii) of the proviso to sub-clause (c), “population” means the population according to the last

preceding census of which the relevant figures have been published before the first day of the previous year;

Conditions to be satisfied for Agricultural Income

According to the definition of Agricultural Income as per Section 2(1A) of the Act, the income which satisfies following onditions 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)]. he operations on the land for agricultural purposes can be:

(i) Basic operation:

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

(ii) Subsequent operations:

These include weeding, digging the soil around the growth, nursing, pruning, cutting, etc. If the person has performed the basic operations on The income shall be agricultural income. For the land whether he has performed the subsequent example: Seller of standing crops, who has put in operations or not. labour and skill to make the crop sprout out of the land, is agricultural income.

If the person has not performed the basic operations The income shall not be agricultural income for him on the land but he has performed the subsequent and it will be taxable under the head Business/ operations Profession. For example: If a person purchases a standing crop, and makes a profit out of it, the income is not agricultural income

Note: Here agriculture connotes all the products of vegetable kingdom (food for human beings and animals, fruits, commercial crops, flowers, medicines, bamboo, timber, fuel material) but it does not include the

products of animal kingdom (dairy farming, butter and cheese making, poultry farming, breeding of live stock etc.).

Concept of Agricultural Income

Agricultural Income means and includes

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

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

II. Revenue income derived from agriculture

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

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

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

(i) The operation must be one which is ordinarily employed by the cultivator to make the produce fit for market, i.e., threshing, winnowing, cleaning, drying, etc.

(ii) There is no market (ready and willing and not a theoretical market) for the produce as received from the farm.

(iii) The process to make it marketable has been performed either by the cultivator or receiver of rent-inkind. (iv) The produce must not change its original character.

IV. Income from sale of produce:

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

V. Income from Building:

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

(a) (i) If the land-lord receives rent in cash, it is owned and occupied by him; or

(ii) If the land-lord receives rent-in-kind, it is occupied by him -whether owned or not; or

(iii) if it is occupied by the cultivator - whether owned by him or not;

(b) If it is on or in the immediate vicinity of the agricultural land;

(c) If it is required as a dwelling-house or as a store house or as an out-house by the land-lord or cultivator;

(d) If it is required by reason of the land-lords or cultivators connection with the land, i.e., either the building is required to make the produce fit to be taken to the market or there is a sufficient quantity of produce which requires a store house or there are numerous tenants and it is

necessary to stay there to collect the rent or it is necessary for the cultivator to be there to look after the farm.
(e) (i) The land is assessed to land revenue in India; or
(ii) The land is subject to land revenue or local rate assessed and collected by the officers of the Government - either Central or State for the benefit of local bodies. Where the land is not so assessed, the building should not be situated:
(a) in an area of municipality (whether known as Municipal Corporation, Notified Area Committee, Town Area Committee, or by any other name or Cantonment Board whose population according to the latest census figures published is 10,000 or more; or
(b) in a notified area within such limits of a Municipality, etc., as may be notified by Government. However, the distance of notified area cannot exceed 8 kilometres from the local limits. The department has issued various circulars from time to time specifying the notified areas.

Income Connected with Land but not Agricultural Income

There are certain incomes which are derived from land but they are not agricultural incomes because the requisite conditions - land must be used for agricultural purposes and it must be the primary source of income - are not satisfied in such cases. Some of the examples of such incomes are as follows:
(a) Income from spontaneous growth of grass, trees or bamboos;
(b) Dividend from a company engaged in agriculture;
(c) Salary of a farm manager;
(d) Income from mines;
(e) Income from stone quarries;
(f) Income from fisheries;
(g) Income from brick making;
(h) Income from supply of water for irrigation purposes;
(i) Profit accruing from the purchase of a standing crop and resale thereof after harvest;
(j) Income from animal kingdom.

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

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

the value calculated according to the average price at which it has been so sold during the relevant previous year;

(b) where agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any process aforesaid, the aggregate of –

(i) the expenses of cultivation;

(ii) the land revenue or rent paid for the area in which it was grown; and

(iii) such amount as the Assessing Officer finds, having regard to all the circumstances in each case, to represent a reasonable profit.

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

Income from manufacture of rubber (Rule 7A)

w.e.f. AY 2002-03

(1) Income derived from the sale of centrifuged latex or cenex or latex based crepes (such as pale latex crepe) or brown crepes (such as estate brown crepe, remilled crepe, smoked blanket crepe or flat bark crepe) or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and thirty-five percent of such income shall be deemed to be income liable to tax.

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

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

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

Treatment of Agricultural Income and Non-Agricultural Income

Partial Integration:

– As observed earlier, the Finance (No. 2) Act, 1977 has introduced certain modifications in computation of tax payable where the assessee (being an individual, association of persons or body of individuals) has both agricultural income and non-agricultural income.

– It may be mentioned that for the first time Finance Act, 1973 introduced the scheme of inclusion of agricultural income in the total income for the limited purpose of determining the amount of tax payable on the non-agricultural income.

– The scheme applies only to those assessees who have simultaneously net agricultural income exceeding ` 5,000 and taxable non-agricultural income i.e.non agricultural income exceeds the basis exemption limit of ` 2,00,000 or ` 2,50,000 or ` 5,00,000 the case may be.

Determination of Tax Liability

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

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

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

– Rebate under Section 86 in respect of share of profit from an association of persons.

– Rebate under Section 92 in respect of doubly taxed income.

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

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.

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

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

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

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

(ii) In the case of an individual, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999 and the Rules made thereunder.

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

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

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

The value of any travel Concession or assistance provided by the employer or the former employer to an Indian Citizen for himself and his family in connection with his proceeding to any place in India on leave

or after retirement from service or after termination of his service is exempt subject to such conditions as may be prescribed having regard to travel concession or assistance granted to the employees of the Central Government. Provided that the amount exempt under this clause shall in no case exceed the amount of expenses actually incurred for the purpose of such travel.

The exemption is admissible in respect of actual expenditure incurred for journeys performed not only by himself (assessee) but also by his family. For the purpose of this clause "family" means:

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

(ii) the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on him. Rule 2B, provides that the value of travel concession or assistance received by or due to the individual from his employer or former employer for himself and his family, in connection with his proceeding:

(a) on leave to any place in India;

(b) to any place in India after retirement from service or after the termination of his service. The exemption can be availed only in respect of two journeys performed in a block of four calendar years. For this purpose, first four year block commenced from calendar year 1986 and the blocks work out as 1986-89, 1990-93, 1994-97, 1998-2001 and so on. If travel concession or assistance is not availed during any of the four year block period, exemption can be claimed provided he avails the concession or assistance in the calendar year immediately following that block. This is popularly known as the 'carry-over' concession. In such cases, the exemption so availed will not be counted for purposes of regulating the future exemptions allowable for the succeeding block of four years.

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

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

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

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

3. Where place of origin of journey and destination or part thereof are not connected by rail, the maximum amount shall be :

(i) where a recognised public transport system exists, the first class or deluxe class fare on such transport by the shortest route to the place of destination.

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

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

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

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

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

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

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

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

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

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

(a) The government; or

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

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

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

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

by the Central Government and partly by one or more State Governments.

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

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

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

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

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

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

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

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

ALLOWANCE PAYABLE OUTSIDE INDIA [SECTION 10(7)]

Allowances or perquisites paid or allowed as such outside India by the Central Government to a citizen of India

for his services rendered outside India, would be wholly exempt from income-tax.

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

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

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

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

For the purposes of this clause “consultant” means:

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

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

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

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

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

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

such individual is required to pay any income tax or social security tax to the country of his origin, provided:
(i) the individual is an employee of the consultant as defined in Section 10(8A) and is either not a citizen of India or, being a citizen of India is not ordinarily resident in India, and
(ii) the contract of service of such individual is approved by the prescribed authority before the commencement of his service.

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

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

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

Fully Exempted

The amount of any death-cum-retirement gratuity received under:
(i) the revised pension rules of the Central Government; or
(ii) the Central Civil Services (Pension) Rules, 1972; or
(iii) any similar scheme applicable to (a), the members of civil services of the Union, or (b) holders of posts connected with defence or of civil posts under the Union, or (c) the member of All India Services, or (d) the members of civil services of a State, or (e) holders of civil posts under a State, or (f) employees of a local authority, or (g) Pension Code or Regulations applicable to the members of the defence services.
is wholly exempt from tax under Section 10(10)(i) of the Act. The payment of gratuity by the Life Insurance Corporation of India under the Staff Regulations is wholly exempt from tax under Section 10(10), as the object and purpose of the gratuity scheme of the Life Insurance Corporation of India and the Revised Pension Rules of the Central Government are the same.

Conditions based Exemption

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

The amount of any gratuity received under The Payment of Gratuity Act, 1972, it shall be exempt from tax to the extent of least of the following:
(a) fifteen days' wages (seven days' wages in case of seasonal establishments) for each completed year of service or part thereof in excess of six months on the basis of salary last drawn for every completed year of service or part thereof in excess of six months; or
(b) the gratuity actually received; or
(c) ` 10,00,000 (limit raised by notification no.43/2010 dt.11-06-2010)

COMMUTATION OF PENSION [SECTION 10(10A)]

(i) Any payment in commutation of pension received under the Civil Pensions (Commutation) Rules or under any similar scheme applicable to Government employees is wholly exempt from tax.
(ii) Any lump sum received on commutation of pension by a Government servant absorbed in a public sector undertakings on or after July 24, 1971 also exempt from tax.

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

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

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

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

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

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

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

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

(ii) Any payment as encashment of earned leave received from any other employer is exempt to the extent of: For non-government employees (including employees of local authority or statutory corporation), least of the following:

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

(ii) 10 month's "average salary", i.e. salary drawn during the period of 10 months immediately preceding

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

(iii) The amount specified by the Government. The maximum amount which is not chargeable to tax under Section 10(10AA) shall be ` 3,00,000.

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

(b) Where the leave encashment is received by the employee from more than one employer in the same previous year, the specified limit in (iii) above would apply to the aggregate of leave encashment received from one or more employers.
(c) Leave salary received by the family of a government servant, who died in harness, is not taxable in the hands of the recipient. [Circular No. 309, dated 3.7.1981]
(d) Leave salary paid to legal heirs of a deceased employee in respect of privilege leave standing to the credit of such employee at the time of his death is an ex-gratia payment on compassionate grounds in the nature of gifts. Thus the payment is not in the nature of salary. [Letter No. 35/1/65, dated 5.11.1965]
(e) The assessee can claim relief from tax under section 89 in respect of leave encashment.

RETRENCHMENT COMPENSATION [SECTION 10(10B)]

Any compensation received by a workman under the Industrial Disputes Act, 1947 or under any other Act or rules, orders or notifications issued thereunder or under any standing orders or under any award, contract of service or otherwise, at the time of his retrenchment. The amount is exempt under this clause to the extent of least of the following limits:
(i) Actual amount received.
(ii) Amount specified by Central Government i.e. ` 5,00,000.
(iii) An amount calculated in accordance with the provisions of clause (b) of Section 25F of the Industrial Disputes Act, 1947 i.e. 15 day's average pay for every completed years of services or part thereof in excess of 6 months.
It may be noted that the above provision shall not apply in respect of any compensation received by a workman in accordance with any scheme which the Central Government may, having regard to the need for extending special protection to the workmen in the undertaking to which such scheme applies and, other relevant circumstances, approve in this behalf and the entire amount of compensation so received shall be exempt.
For this purpose retrenchment includes the closing down of the undertaking and transfer of the ownership or management of the undertaking provided the service of the workman has been interrupted by transfer; or the new terms and conditions of service are less favourable to him; or the new employer is, under the terms of transfer or otherwise legally not liable to pay to the workman, in the event of his retrenchment, compensation on
the basis that his service has been continuous and has not been interrupted by the transfer. "Wages", in the context of Section 10(10B), means:
– all remuneration capable of being expressed in terms of money, which would be payable to a workman in respect of employment or of work done in such employment, if the terms of employment, express or implied, were fulfilled.
– "Wages" also include (i) such allowances, including DA as the workman is entitled to; (ii) the value of any house accommodation, or

supply of light, water, medical attendance or other amenity, or of any other service, concessional supply of foodgrains, or other articles; and (iii) any travel concession.

– However, "wages do not include: (i) any bonus; (ii) contribution to a retirement benefit scheme; (iii) any gratuity payable on the termination of his service.

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

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

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

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

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

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

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

The amended provision provides for exemption of any amount received or receivable by an employee of a public sector company or of any other company or an authority established under Central, State or Provincial Act or a local authority, or any State Government or Central Government or the Institution having importance throughout India or a recognised management institute, on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company, a scheme of voluntary separation.

The scheme of voluntary retirement are to be framed in accordance with such guidelines as may be prescribed which may include among other things the criteria of economic viability. The amount of exemption is the actual amount of compensation or ` 5,00,000, whichever is less. This exemption is available only once in the life time of an assessee. The assessee shall not be eligible for relief under section 89 in case he has claimed exemption under section 10(10C). On the other hand, if he claims relief under section 89, he cannot claim exemption under section 10(10C)

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

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

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

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

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

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

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

The accumulated balance due and becoming payable to an employee participating in a recognised provident fund, would be exempt from tax if the following conditions are satisfied:
(i) The employee has rendered continuous service with his employer for a period of 5 years or more; or
(ii) Where he has not rendered such continuous service, the service has been terminated by reason of employee's ill-health or by the contraction or discontinuance of the employer's business or by any other cause beyond the control of the employee; or
(iii) On cessation of his employment he obtains employment with any other employer and the balance standing in his Recognised Provident Fund is transferred to his account in a Recognised Provident Fund maintained by the new employer.

Where the accumulated balance of the fund has been transferred to any other such fund, then in computing the period of continuous service for clause (i) or clause (ii) the period or periods for which such employee

rendered continuous service under his former employer or employers shall be included.

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

Any payment from an approved superannuation fund made:

(i) on the death of the beneficiary; or

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

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

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

HOUSE RENT ALLOWANCE [SECTION 10(13A)]

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

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

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

(iii) an amount equal to:

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

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

SPECIAL ALLOWANCE [SECTION 10(14)]

(a) Any special allowance in cash or the value of any benefit granted by the employer to an employee with the specific object of enabling the employee to meet expenses 'wholly', 'necessarily' and 'exclusively' incurred by him in the performance of the duties of his office or employment of profit, is exempt from tax to the extent to which such expenses are actually incurred for that purpose. This allowance may include travelling allowance to agents, conveyance allowance, transfer allowance, etc., but it does not include entertainment allowance, perquisites and the allowance to meet personal expenses (i.e. City Compensatory Allowance) at the place where the duties of office are performed by him or at the place where he ordinarily resides [Addl. C.I.T. v. A.K. Mishra 117 ITR 342 (All.)]. It must be noted that to be eligible for exemption the amount must have been actually expended. Where a surplus remains in the hands of the assessee out of a lump sum paid to him by the employer for the purpose, the surplus would be taxable in the hands of the assessee as income. This is irrespective of the

fact that the employer does not demand refund of the amount not expended [CIT v. Tejaji Farasram Kharawalla Ltd. (1968) 67 ITR 95 (SC)].

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

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

Rule 2BB. Prescribed allowances for the purposes of clause (14)(i) of Section 10 - For the purposes of sub-clause

(i) of clause (14) of Section 10, prescribed allowances, by whatever name called, shall be the following, namely –

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

(b) any allowance, whether granted on tour or for the period of journey in connection with transfer, to meet the

ordinary daily charges incurred by an employee on account of absence from his normal place of duty;

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

Provided that free conveyance is not provided by the employer;

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

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

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

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

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

Sl. Name & Nature of allowance Extent to which allowance is exempt No.

1. Any special compensatory allowance in the nature of `800 per month or `7,000 per month or `300 composite hill compensatory allowance or high altitude per month depending upon the specified allowance or uncongenial climate allowance or snow locations bound area allowance or avalanche allowance
2. Any Special Compensatory Allowance in the Nature of `1,300 per month or `1,100 per month or Border Area Allowance, Remote Locality Allowance or `1,050 per month or ` 750 per month or Difficult Area Allowance or Disturbed Area Allowance `300 per month or `200 per month depending upon the specified locations
3. Tribal area allowance `200 per month
4. Any allowance gran-ted to an employee working in any 70 per cent of such allowance upto a transport system to meet his personal expenditure maximum of `6,000 per month 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
5. Children education allowance `100 per month per child up to a maximum of two children
6. Any allowance granted to an employee to meet the `300 per month per child up to a maximum hostel expenditure on his child of two children
7. Compensatory field area allowance `2,600 per month
8. Compensatory modified field area allowance `1,000 per month
9. Any special allowance in the nature of counter insurgency ` 3,900 per month allowance granted to the member of armed forces operating in areas away from their permanent locations for a period of more than 30 days.
10. Transport allowance granted to an employee to meet ` 800 per month his expenditure for the purpose of computing between the place of his residence and the place of his duty.
11. Transport allowance granted to an employee, who is ` 1600 p.m. blind or orthopedically handicapped with disability of lower extremities, to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty 12. Underground allowance ` 800 p.m.

Provided that any assessee claiming exemption in respect of the allowances mentioned at serial numbers 7 and 8 shall not be entitled to the exemption in respect of the allowance referred to at serial number 2.
Provided further that any assessee claiming exemption in respect of the allowance mentioned at serial number 9 shall not be entitled to the exemption in respect of disturbed area allowance referred to at serial number 2.

Interest from certain Investments [Section 10(15)]

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

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

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

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

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

(iv) Interest received by a non-resident Indian from notified bonds (i.e., NRI Bonds, 1988, issued by State Bank of India), NRI Bonds (Second Series) issued by State Bank of India or by an individual owning such bonds by virtue of being a nominee or survivor of such non-resident Indian or by an individual to whom the bonds have been gifted by the non-resident Indian (applicable from the assessment year 1989-90). [Exemption will be available only if the bonds are purchased by a non-resident Indian in foreign exchange. The interest and principal received in respect of such bonds whether on their maturity or otherwise, is not allowable to be taken out of India. Where the individual who is a non-resident Indian in the previous year in which the bonds are acquired, becomes a resident in India in any subsequent year the interest received from such bonds will continue to be exempt in the subsequent years as well]. If the bonds are encashed in a previous year prior to their maturity by an individual who is so entitled, the exemption in relation to the interest income shall not be available to such individual in the assessment year relevant to such previous year in which the bonds have been encashed specified up to 31-5-2002 only.

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

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

(via) Interest payable to European Investment Bank, on a loan granted by it in pursuance of the frameworkagreement for financial co-operation entered on the 25th day of November, 1993 by the Central Government with that Bank.

(a) Interest payable by the Government or a local authority on moneys borrowed by it before the 1st day of June, 2001 from, or debts owned by it before the 1st day of June, 2001 to sources outside India.

(b) Interest payable by an industrial undertaking on moneys borrowed by it under a loan agreement entered into before 1st day of June 2001 with any such financial institution in a foreign country as may be approved in

this behalf by the Central Government by general or special order. The International Finance Corporation, Washington; Export Import Bank of Washington, Washington, D.C.; Export Import Bank of Japan, Tokyo; The Development Loan Fund, Columbia, U.S.A.; The West German Bank for Reconstruction, West Germany and the Banque Francaise de Commerce Exterior, Paris.

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

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

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

(f) Interest payable by an industrial undertaking in India on any moneys borrowed by it in a foreign currency from sources outside India under an approved loan agreement before the 1st day of June, 2001. (fa) Interest payable by a schedule bank, to a non-resident or to a person who is not ordinarily resident within the meaning of Section 6 on deposit in foreign currency where acceptance of such deposits by the bank is approved by the Reserve Bank of India. (g) Interest payable by a public company formed and registered in India, and eligible for deduction under Section 36(1)(viii), with the main objective of carrying on business of providing long-term finance for construction or purchase of houses in India for residential purposes on any moneys borrowed by it in foreign currency from sources outside India under an approved loan agreement, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government before 1st day of June 2003.

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

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

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

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

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

Scholarships [Section 10(16)]

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

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

The provisions in this regard are as follows:

Any income by way of:

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

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

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

Awards/Rewards [Section 10(17A)]

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

Pension [Section 10(18)]

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

Family Pension [Section 10(19)]

Family pension received by the widow or children or nominated heirs, as the case may be, of a member of the armed forces (including paramilitary forces) of the Union, where the death of such member has occurred in the

course of operational duties, in such circumstances and subject to such conditions, as may be prescribed, shall be exempt from tax. However, family pension received by others is exempt upto least of `15,000 or 1/3rd of family pension and it is taxable under the head other sources.

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

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

Income of Local Authorities [Section 10(20)]

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

Income of Research Associations [Section 10(21)]

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

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

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

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

(iv) voluntary contribution received and maintained in the form of jewellery, furniture or any other article as the Board may by notification in the official gazette, specify,

for any period during the previous year otherwise than in the forms and modes as specified in Section 11(5). However, the exemption under this clause shall not be denied in relation to voluntary contribution, other than voluntary contribution in cash or voluntary contribution of the nature referred to (i), (ii), (iii) and (iv) above, subject to condition that such voluntary contribution is held by the research association only in the forms or modes as specified in Section 11(5) after the expiry of one year

from the end of the previous year in which such asset is acquired or the 31st day of March, 1992 whichever is later.

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

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

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

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

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

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

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

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

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

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

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

With effect from the assessment year 1996-97 a new clause (23AAA) has been inserted in Section 10. It provides for exemption from tax on any income received by any person on behalf of a fund, established for such purposes as may be notified by the Board, for the welfare of employees or their dependents and of which fund such employees are members. The exemption will be available only if the fund applies its income, or accumulates it for application, wholly and exclusively, to the objects for which it is established. The aforesaid fund shall invest its funds and contributions made by the employees and other sums received by it in any one or more of the forms or modes specified in Section 11(5). The said fund is to be approved by the Commissioner in

accordance with the rules made in this behalf and such approval shall have effect for such assessment year or years not exceeding three assessment years as may be specified in the order of approval.

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

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

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

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

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

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

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

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

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

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

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

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

behalf. A new clause (23BBC) is inserted in Section 10 so as to provide exemption from income-tax of any income derived by the SAARC Fund for Regional Projects which was set up by Colombo Declaration issued on 21st

December, 1991 by the Heads of State or Government of the Member-countries of South Asian Association for Regional Corporation established on 8th December, 1985 by the Charter of the South Asian Association for Regional Corporation.

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

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

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

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

Income of IRDA [Section 10(23BBE)]

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

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

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

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

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

(i) the Prime Minister's National Relief Fund; or

(ii) the Prime Minister's Fund (Promotion of Folk Art); or

(iii) the Prime Minister's Aid to Students Fund; or

(iiia) the national foundation for communal harmony.

(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 preceeding year, such body shall:

(a) publish its accounts in a local news paper; and

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

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

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

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

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

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

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

(ia) any asset, being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution where such asset form part of the corpus of any university or other educational institution or any hosital 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 subclause
(v) or sub-clause (vi) or sub-clause (via) shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or other medical institution, as the case may be, is established.

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

In case the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in the first proviso makes an application on or after the 1st day of June, 2006 for the purposes of grant of exemption or continuance thereof, such application shall be

made on or before the 30th day of September of the relevant assessment year from which the exemption is sought.

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

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

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

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

Explanation: For the purpose of this clause:

(a) the expression 'public sector bank' means the State Bank of India constituted under the State Bank of India Act, 1955, a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959, a corresponding new Bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer

of Undertakings) Act, 1970 or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 and a bank included in the category "other public sector banks" by the Reserve Bank of India;

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

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

(i) ICICI.

(ii) IFCI.

(iii) IDBI.

(iv) LIC.

(v) UTI.

(vi) The Industrial Reconstruction Corporation of India established under the Industrial Reconstruction Bank of India Act, 1984 (62 of 1984).

(vii) The General Insurance Corporation of India established under the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972).

(viii) The National Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).

(ix) The New India Assurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).

(x) The Oriental Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).

(xi) The United Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).

(xii) Risk Capital and Technology Finance Corporation Ltd.

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

(c) the expression 'Securities and Exchange Board of India' shall have the meaning assigned to it in clause

(a) of Sub-section (1) of Section 2 of the Securities and Exchange Board of India Act, 1992.

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

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

(i) In case of securitisation vehicles which are set up as a trust and the activities of which are regulated by either SEBI or RBI, the income from the activity of securitisation of such trusts will be exempt from taxation.

(ii) The securitisation trust will be liable to pay additional income-tax on income distributed to its investors on the line of distribution tax levied in the case of mutual funds. The additional income-tax shall be levied @ 25% in case of distribution being made to investors who are individual and HUF and @ 30% in other cases. No additional income tax shall be payable if the income distributed by the securitisation trust is received by a person who is exempt from tax under the Act.

(iii) Consequent to the levy of distribution tax, the distributed income received by the investor will be exempt from tax.

(iv) The securitisation trust will be liable to pay interest at the rate of one percent for every month or part of the month on the amount of additional income-tax not paid within the specified time.

(v) The person responsible for payment of income or the securitisation trust will be deemed to be an assessee in default in respect of amount of tax payable by him or it in case the additional income-tax is not paid to the credit of Central Government.

(a) "Securitisation" shall have the same meaning as assigned to it,–

(i) in clause (r) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the Securities Contracts (Regulation) Act, 1956 (42 of 1956); or

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

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

(b) "Securitisation trust" shall have the meaning assigned to it in the Explanation below section 115TC; Securitisation Trust means a trust, being a –

(i) "special purpose distinct entity" as defined in regulation 2(1)(u) of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the Securities Contracts (Regulation) Act, 1956 (42 of 1956), and regulated under the said regulations; or

(ii) "Special Purpose Vehicle" as defined in, and regulated by, the guidelines on securitisation of standard assets issued by the Reserve Bank of India, which fulfils such conditions, as may be prescribed.

Income of Investor Protection Fund (Section 23EA)

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

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

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

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

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

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

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

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

Any income, by way of contributions received from a depository, of such Investor Protection Fund set up in accordance with the regulations by a depository as the Central Government may notify shall be exempt. However, where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with a depository, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall, accordingly, be chargeable to income-tax.

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

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

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

(A) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 (hereinafter referred to as the Venture Capital Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992); or

(B) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (hereinafter referred to as the Alternative Investment Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and which fulfils the following conditions, namely:–

(i) it is not listed on a recognised stock exchange;

(ii) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking; and

(iii) it has not invested in any venture capital undertaking in which its director or a substantial shareholder (being a beneficial owner of equity shares exceeding ten per cent of its equity share capital) holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking;

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

(A) Operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), which –

(I) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Venture Capital Funds Regulations; or

(II) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund under the Alternative Investment Funds Regulations and which fulfils the following conditions, namely: –

(i) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking;

(ii) it has not invested in any venture capital undertaking in which its trustee or the settler holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking; and

(iii) the units, if any, issued by it are not listed in any recognised stock exchange; or

(B) operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(c) "venture capital undertaking" means –

(i) a venture capital undertaking as defined in clause (n) of regulation 2 of the Venture Capital Funds Regulations; or

(ii) a venture capital undertaking as defined in clause (aa) of sub-regulation (1) of regulation 2 of the Alternative
Investment Funds Regulations
As per Regulation 2(n) of Venture Capital Funds Regulations "Venture capital undertaking" means—
(1) whose shares are not listed on a recognised stock exchange in India
(2) which is engaged in the business for providing services , production, or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by the Board with the approval of central government by notification in the official gazette in this behalf or As per Regulation 2(1)(aa) of the Alternative Investment Funds Regulations, Venture capital undertaking means domestic company
(1) which is not listed on recognised stock exchange in India at the time of making investment and
(2) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors
– Non Banking Financial Company (NBFC)
– Gold Financing
– Activities not permitted under industrial policy of Government of India.
– Any other activity which may specified by the Board in consultation with Government of India.

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

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

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

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

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

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

Employees' State Insurance Corporation set up under the provisions of the Employees' State Insurance Act, 1948.

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

Members of a Scheduled Tribe as defined in Article 366(25) of the Constitution residing in certain areas specified in paragraph 20 of the Sixth Schedule to the Constitution or in the States of Arunachal Pradesh, Mizoram, Nagaland, Manipur and Tripura or in the Ladakh region of the State of Jammu and Kashmir are exempt from tax on any income which accrues or arises to them from any source in the area, State or Union Territories mentioned above or by way of dividend or interest on securities arising from any place in or outside India.

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

Any income accruing or arising to any person from any source in the district of Ladakh or outside India in any previous year relevant to the assessment year commencing before 1.4.1989 will be exempt from tax, where such person is resident in the district of Ladakh in that previous year. However, this exemption would not apply in the case of any such person unless he was resident in that district in the previous year relevant to the assessment year 1962-63 or earlier. For the purposes of this section the district of Ladakh will include all the areas comprised in that district on June 30, 1979, that is, the date after which the said district was bifurcated.

Income of a Corporation Established for Promoting Interest of Scheduled Castes etc. [Section 10(26B)]

Any income of a corporation established by a Central, State or Provincial Act or any other body, institution or association wholly financed by government where it has been formed for promoting the interest of the members of the Scheduled Castes or the Scheduled Tribes or the backward classes or any two or all of them is exempt from tax.

Exemption to National Minorities Development and Finance Corporation [Section 10(26BB)] With effect from the assessment year 1995-96 a new clause (26BB) has been inserted in Section 10 to provide income-tax exemption on any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of such minority communities as are notified by the Central Government from time to time.

Exemption from Income of a Corporation established for the Welfare and Economic Upliftment of Ex-servicemen being Citizens of India [Section 10(26BBB)]

Finance Act, 2003 has inserted a new clause (26BB) in Section 10 to provide income-tax exemption on any income of a corporation established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen being the citizens of India. [Section 10(26BBB)].

Income of Co-operative Societies Promoting the Interest of Members of Scheduled Castes, etc. [Section 10(27)]

Any income of a cooperative society formed for promoting the interests of the members of either the scheduled castes or scheduled tribes or both referred to in clause (26B) will be exempt from tax. In order to avail

exemption the membership of the co-operative society should consist of only other co-operative societies formed for similar purposes and the finances of the society are provided by the government and such other societies.

Exemption of Commodity Boards and Authorities from Income-tax [Section 10(29A)]

A new clause (29A) has been inserted in Section 10. It provides that the income of certain commodity Boards and Export development authorities which are set up under various statutes and are under the administrative control of the Commerce Ministry will be exempt from income-tax. The specified boards and authorities are Coffee Board, the Rubber Board, the Tea Board, the Tobacco Board, the Marine Products Export development authority, the Agricultural and Processed Food Products Export Development Authority, the Spices Board and the coir Board established under section 4 of the Coir Industry Act (w.r.e.f 1st April, 2002). These Boards and authorities are exempt from the assessment year 1962-63 or the previous year in which these Boards or authorities were constituted, whichever is later.

Subsidy from the Tea Board [Section 10(30)]

In the case of an assessee engaged in the business of growing and manufacturing tea in India, the amount of Subsidy received from or through the Tea Board under any Notified Scheme of the Central Government for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea is exempt from income-tax.

For this purpose, the Central Government has notified the following schemes -

(1) Replantation Subsidy Scheme of the Tea Board from October 1, 1968 (effective date 1.4.1969);

(2) Amended Replantation Subsidy Scheme of the Tea Board as effective from May 12, 1970; and

(3) Amended Replantation Subsidy Scheme of the Tea Board as effective from January 1, 1972.

To qualify for the exemption, the assessee has to submit, along with his return of income or within such further time as may be allowed by the Assessing Officer, a certificate from the Tea Board as to the amount of subsidy received by him during the relevant previous year.

Subsidy from the Rubber; Coffee; Spices and other Board or authority established under any law and notified by the Central Government [Section 10(31)]

In the case of an assessee carrying on business of growing and manufacturing rubber, coffee, cardamom or such other commodity in India, as notified by the Central Government, any subsidy received from or through the concerned Board(s) (as specified in the heading) under any scheme for replantation or replacement of rubber, coffee, cardamom or other specified commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom or other specified commodity will be exempt from tax if the assessee furnishes to the Assessing Officer, along with his return of income a certificate from the concerned Board, as to the amount of such subsidy paid to the assessee,

either along with his return of income or within such further time as may be allowed by the Assessing Officer.

Income of minor child [Section 10(32)]

Where the income of an individual includes any income of his minor child in terms of Section 64(1A), such individual shall be entitled to exemption of the amount includible under Section 64(1A) of each minor child or ` 1,500 for each minor child whichever is less.

Income from transfer of units of UTI [Section 10(33)]

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 referred to in Schedule I to the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002) and where the transfer of such asset takes place on or after the 1st day of April, 2002 shall be exempt from income tax.

Any income by way of dividends referred to in Section 115-O [Section 10(34)]

Any income by way of dividends referred to in Section 115-O shall be exempt from income tax. As per section 115-O the company paying or declaring any dividend have to pay tax @15% plus surcharge 5% or 10% as the case may be plus education cess @3% on such dividend. Hence, such dividend shall be exempt in the hands of shareholders.

Any distributed income by way of Buy back of shares referred in section 115QA [Section 10(34A)]

Any income arising on account of buy back of shares (not being listed on a recognised stock exchange) by the company as referred to in section 115QA shall be exempt in the hands shareholders.

As per section 115QA, the company shall be liable to pay tax @20% plus surcharge plus education cess and SHEC on such distributed income on account of buy back of shares. Distributed income means the consideration

paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares.

Income from Mutual Funds and certain units [Section 10(35)]

Any income by way of, –

(a) income received in respect of the units of a Mutual Fund specified under Clause (23D); or

(b) income received in respect of units from the Administrator of the specified undertaking; or

(c) income received in respect of units from the specified company shall be exempt from income tax.

Provided that this clause shall not apply to any income arising from transfer of units of the Administrator of the specified undertaking or of the specified company or of a mutual fund, as the case may be.

Any income received by the investor distributed by Securitisation Trust under Section 115TA

[Section 10(35A)]

Any income by way of distributed income referred to in section 115TA received from a securitisation trust by any person being an investor of the said trust shall be exempt.

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.

Income from Transfer of Agricultural Land [Section 10(37)]

In the case of an assessee, being an individual or a Hindu undivided family, any income chargeable under the head "Capital gains" arising from the transfer of agricultural land, where –

(i) such land is situate in any area referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of Section 2;

(ii) such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual or a parents;

(iii) such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India;

(iv) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after 1st day of April, 2004. shall be exempt from income tax.

Explanation: For the purposes of this clause, the expression "compensation or consideration" includes the compensation or consideration enhanced or further enhances by any court, tribunal or other authority.

Income from Transfer of certain equity, units etc. [Section 10(38)]

Any income arising on or after 1.10.2004 from the transfer of long-term capital asset, being an equity share in a
company or a unit of an equity oriented fund where –

(a) the transaction of sale of such equity share or unit is entered into on or after the date on which Chapter VII of the Finance (No. 2) Act, 2004 comes into force; and

(b) such transaction is chargeable to securities transaction tax under that chapter. shall be exempt from income tax. Provided that the income by way of long-term capital gain of a company shall be taken into account in computing the book profit and the income tax payable under Section 115JB.

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.

Income from subsidiary company [Section 10(40)]

Any income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power if receipt of such income is for settlement of dues in connection with

reconstruction or revival of an existing business of power generation shall be exempt from income tax.

Provided that the provisions of this clause shall apply if reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under sub-clause (a) of clause (v) of Sub-section (4) of Section 80-IA.

Income from transfer of a capital asset [Section 10(41)]

Any income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation or transmission or distribution of power where such transfer is effected on or before the 31st day of March, 2006, to the Indian company notified under sub-clause (a) of clause (v) of Sub-section (4) of Section 80- IA shall be exempt from income tax.

Specified income to a body or authority [Section 10(42)]

Any specified income arising to a body or authority which –

(a) has been established or constituted or appointed under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;

(b) is established or constituted or appointed not for the purposes of profit;

(c) is notified by the Central Government in the Official Gazette for the purposes of this clause.

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 hiers of the borrower to repay the loan amount along with interest for the release of property.

New Pension System Trust [Section 10(44)]

Any income received by any person for, or on behalf of, the New Pension System Trust established on the 27th
February, 2009 under the provisions of the Indian Trust Act, 1882 shall be exempt from Incom tax.

Allowance or Perquisite to the chairman of UPSC [Section 10(45)]

Allowances or perquisites which are notified by the Central Government in the Official Gazette shall be exempt
in the hands of the Chairman or a retired Chairman or any other member or retired member of the Union Public
Service Commission.

Income arising to a Body, Authority or Board or Trust or Commission [Section 10(46)]

Any specified income notified by the Central Government arising to a body or authority or Board or Trust or Commission (by whatever name called) which:

(a) has been established or constituted by or under a Central, State or Provincial Act, or constituted by the Central Government or a State Government, with the object of regulating or administering any activity for the benefit of the general public;

(b) is not engaged in any commercial activity; and

(c) is notified by the Central Government in the Official Gazette shall be exempt.

Income of an Infrastrucutre Debt Fund [Section 10(47)]

Any income of an infrastructure debt fund, set up in accordance with the guidelines as may be prescribed, which is notified by the Central Government in the Official Gazette shall be exempt.

Income received by certain foreign companies in India in Indian currency from sale of crude oil to any person in India [Section 10(48)]

Any income received in India in Indian currency by a foreign company on account of sale of crude oil, any other goods or rendering of services, as may be notified by Central Government this behalf, to any person shall be exempt in the hands of Foreign Company.

However, to claim this exemption the following conditions may be satisfied:

(i) receipt of such income in India by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government;

(ii) having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf; and

(iii) the foreign company is not engaged in any activity, other than receipt of such income, in India.]

Income of National Financial Holdings Company Limited [Section 10(49)]

Any income of the National Financial Holdings Company Limited, being a company set up by the Central Government, of any previous year relevant to any assessment year commencing on or before the 1st day of April, 2014 shall be exempt.

SPECIFIC EXEMPTION

We have discussed general exemption generally available to all assessee depending upon the purpose for which it is made. Now let us discuss section 10AA, etc., relating to specific exemption available to industrial undertakings on fulfillment of specified conditions.

Special provisions in respect of newly established Units in Special Economic Zone (Section 10AA)

(1) Subject to the provisions of this section, in computing the (j) of section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any

service during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2006, a deduction of –

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

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

(2) The deduction under clause (ii) of sub-section (1) shall be allowed only if the following conditions are fulfilled, namely:

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

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

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

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

(3) Where any amount credited to the Special Economic Zone Re-investment Reserve Account under clause (ii) of sub-section (1), –

(a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilised; or

(b) has not been utilised before the expiry of the period specified in sub-clause (i) of clause (a) of subsection

(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).

TAX EXEMPTIONS FOR CHARITABLE TRUSTS AND INSTITUTIONS

Notes

Before the discussion of the provisions of the Income-tax Act in this connection, it is important to note the meanings of the terms - Trust, Institution, Income from property, Charitable purpose and Religious purpose.

(a) **Trust**: Section 3 of the Indian Trusts Act defines a trust to mean "an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another and the owner".

(b) **Institution**: An organisation with a constitution composed of a President, Vice-President, Secretary, Committee Members and ordinary members, is known as an Institution. The activities of the institution and its office-holders are regulated by rules and bye-laws of the institution. A university or a Chamber of Commerce is an Institution.

(c) **Income from property:** This includes income from movable or immovable property, voluntary donations received and income from business undertaking(s) held by the trust.

(d) **Charitable purpose**: The term 'charitable purpose' has been defined in this Act in a wider sense than what is commonly understood. According to Section 2(15) of the Act, it includes relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and advancement of any other object of general public utility not involving the carrying on of any activity for profit. In order to qualify for tax exemptions the charity must be of a public character, and the trust or institution should not be created or established for the benefit of any particular religious community or caste, if the trust or institution is established for the benefit of the member of a club or employees of a factory, it would not be a public charitable trust. Vide Circular No. 395 dated Sept. 24, 1984 promotion of sports and games is considered to be a charitable purpose within the meaning of Section 2(15). Accordingly an association or institution, engaged in the promotion of sports or games can claim exemption under Section 11, even if it is not approved under Section 10(23).

If advancement of any other object of general public utility involves any activity in the nature of trade, commerce or business or any activity of rendering any service in relation to any trade, commerce for any fee shall not considered as charitable purpose however this restriction shall be applicable only if total receipts from these activities exceeds ` 25 lakh in a previous year.

Income not to be included in the Total Income

According to Section 11(1), the following items of income are not to be included in the total income of the previous year of the assessee who is in receipt of the same:

(i) **Income derived from property held under trust wholly for charitable or religious purposes:** Income derived from property held under trust wholly for charitable or religious purposes shall be exempt to the extent to which such income is applied for such purposes in India and where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of 15% of the income from such property.

(ii) **Income derived from property held under trust in part only for charitable or religious purposes:** Income derived from property held under trust in part only for charitable or religious purposes shall be exempt. This exemption would, however, be available only for trusts created before 1.4.1962. Further, where any such income is finally set apart for application to such purposes in India, shall be exempt to the extent to which the income so set apart is not in excess of 15% of the income from such property.

(iii) **Income from property held under trust created on or after 1.4.1952** for a charitable purpose which tends to promote international welfare in which India is interested shall be exempt to the extent to which such income is applied for such charitable purposes outside India.

(iv) **Income from property held under trust created before 1.4.1952** for charitable or religious purposes shall be exempt to the extent to which such income is applied for such purposes outside India. This exemption is, however, subject to the condition that the Central Board of Direct Taxes has, by a general or special order, issued a direction in either of the above two cases that the income in question would not be included in the total income of the person in receipt of such income.

(v) **Income in the form of voluntary contributions** made with a specific direction that they shall form part of the corpus of the trust or institution shall be fully exempt.

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.

Assets held partly for religious or charitable purposes

It is quite possible that a capital asset is held by a trust partly for religious or charitable purposes. Where such a capital asset is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified here under:

(i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;
(ii) in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

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 Subsection
(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.

Forms and Modes of Investment [Section 11(5)]

The forms and modes for investing funds of charitable and religions trusts and institutions are given hereunder: (i) investment in saving certificates as defined in clause (c) of Section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government. Investments in Indira Vikas Patra and Kisan Vikas Patra also qualify for the purpose of this Section;
(ii) deposit in any account with the Post Office Savings Bank;
(iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business
of banking (including a co-operative land mortgage bank or a co-operative land development bank);

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.

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 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.

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 satified that the activites of the trust or institution are not genuine or are not carried out in accordance with the objects of the trust or institution then the commissioner may pass an order in writing for the cancellation of registration granted under section 12AA or under section 12A after giving an opportunity of being heard.(Inserted by the Finance Act, 2010, w.e.f. 1-6-2010.)

TAX EXEMPTIONS TO POLITICAL PARTIES (SECTION 13A)

'Political party' means an association or body of individual citizens of India registered with the Election Commission of India as a political party and includes a political party deemed to be registered with that Election Commission of India.

Political parties are liable to pay tax on their income and they are assessed as 'An association of persons'. However, the income derived by these parties as income by way of voluntary contributions, Income from House Property; and Income from Other Sources or Capital Gains are exempt from subject to the following conditions: (i) the party keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce the income;

(ii) in respect of each such voluntary contribution in excess of ` 20,000, the party keeps and maintains a record of the contributions and names and addresses of the persons who have made such contribution; and

(iii) the accounts of the party are audited by a Chartered Accountant or other qualified accountant. The Chief Executive Officer of the political party is required to file a return of income if the total income (computed

under this Act without giving effect to the provisions of Section 13A) exceeds the maximum amount which is not chargeable to income-tax. In this connection, the provisions of Section 139(1) shall apply.

VOLUNTARY CONTRIBUTIONS RECEIVED BY AN ELECTORAL TRUST (SECTION 13B)

Any voluntary contributions received by an electoral trust shall not be included in the total income of the previous year of such electoral trust, if (a) such electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951, during the said previous year, ninety-five per cent of the aggregate donations received by it during the said previous year along with the surplus, if any brought forward from any earlier previous year; and

(b) such electoral trust functions in accordance with the rules made by the Central Government. 'Electoral Trust' mens a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government.

REVIEW QUESTIONS

1. State the conditions which are essential to support a claim for exemption of income of public charitable
2. trust under Section 11 of the Income-tax Act, 1961.
3. Enumerate the privileges conferred on a foreign technician by the Income-tax Act, 1961 and the conditions
4. to be fulfilled for eligibility of the concessions.
5. What are the provisions relating to exemption of income of a political party? Discuss.
6. What are the conditions to be satisfied to enable the Electoral Trust to claim full exemption?
7. What are the benefits available to a 100 per cent export oriented unit? Describe the eligibility conditions for
8. availing such benefits under Section 10B of the Act.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

UNIT-4 COMPUTATION OF TOTAL INCOME UNDER VARIOUS HEADS

CONTENTS

- Basis of Charge
- Salary
- Allowances
- Perquisites
- cases of Specified Employees
- Valuation of Perquisites
- Rent-free/Concessional rent residential accommodation
- Profits in Lieu of or in Addition to Salary
- Deductions Allowed from Salaries
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- Incomes exempt from Tax and not includible in 'Salary'
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Income under the Head Salaries

All income received as salary under Employer – Employee relationship is taxed under this head. On due or receipt basis, whichever arises earlier. Employers must withhold tax compulsarily (subject to section 192), if income exceeds minimum exemption limit, as tax deducted at source (TDS), and provide their employees Form 16 which shows the total amount of tax deducted from his net income.

BASIS OF CHARGE

As per Section 15, the income chargeable to income tax under the head salaries would include : Any salary due to an employee from an employer or a former employer during the previous year irrespective of the fact whether it is paid or not.

Any salary paid or allowed to the employee during the previous year by or on behalf of an employer, or former employer, would be taxable under this head even though such amounts are not due to him during the accounting year

Arrears of salary paid or allowed to the employee during the previous year by or on behalf of an employer or a former employer would be chargeable to tax during the previous year in cases where such arrears were not charged to tax in any earlier year.

However it would not include:

– Any salary paid in advance and included in the total income of any person for any previous year, shall not be included again in the total income of the person when the salary becomes due. – Any salary, bonus, commission or remuneration, by whatever name called, due to, or

received by, a partner of a firm from the firm shall not be regarded as "salary" for the purposes of this section.

Due Basis of Taxation

The basis of taxation of income from salary is normally on 'due' basis. Thus, salary due to an employee is taxable regardless of the fact whether he actually receives it or not. Exceptions to this rule are of cases where salary is received in advance by an employee which is chargeable to tax as and when it is received although the salary is not due to him. But in order to ensure that there is no double taxation of the same item of income in the hands of the same employee, the explanation to Section 15 specifically provides that where an item of a salary income received by an employee in advance is taxed as and when it is received, it shall not again be charged to tax when it becomes due to the assessee. In order to attract liability to tax under this head, it is not essential that the employee, who is liable to tax under this head, must receive salary from his present employer.

Computation of Salary in the Grade System

An employee may be entitled to receive salary in grade system. Under this system, the normal annual increments to be given to the employee are already fixed in the grade. For example, if an employee joins the service on 1.6.2010 and is placed in the grade of ` 10,000-1,000-15,000-2,000-25,000 then his salary from 1.6.2010 will be ` 10,000 p.m. and thereafter his salary will be ` 11,000 p.m. w.e.f. 31.5.2011 until it reaches ` 15,000 after which it will increase annually by ` 2,000 until it reaches ` 25,000. After that, employee will be placed in another grade. In certain cases, employee joins in the grade at a salary in between the grade, in that case his salary will annually increase in the aforesaid manner the only difference would be that his initial salary would be a different amount than the start of the grade.

Employer and Employee Relationship

The salary of an employee is a separate source, distinct from other classes of income. The basis of liability under the head salaries is the employer-employee relationship. Before charging the particular income received by a person under this head, care must be taken to ensure that there exists such a relationship of employer and employee between the recipient and the payer of the income. The payments chargeable under the head salaries must be made between the persons who are in the relationship of employer and employee. Therefore, the amount received by an individual shall be treated as salary only if the relationship between payer and payee is of an employer and employee or master and servant. Employer may be an individual, firm, and association of persons, company, corporation, Central Government, State Government, public body or a local authority. Likewise, employer may be operating in India or abroad. The employee may be full time employee or part-time employee.

The question whether a particular person receives the income in his capacity as an employee or not has to be decided from the facts of each case.

Let's examine the following cases, whether payments are chargeable under head salaries;

(i) The professor of university would be receiving income by way of monthly salary from the university which is chargeable to tax under this head. But this does not mean that every item of income received by the employee from his employer would be taxable under this head. Thus, income by way of examinership fees received by a professor from the same university in which he is employed would not be chargeable to tax under this head but must be taxed as Income from other sources under Section 56. This is because of the fact that the essential condition that the income in question must be received for services rendered in the ordinary course of employment would not be fulfilled in the case of examinership fees.

(ii) A director of a company may, in some cases, be an employee of a company where there is a specific contract of employment between him and the company. The fact that the same person has dual capacity in his relationship with the company does not mean that he cannot be taxed under this head. Every item of income arising to such a director who is also an employee of the company (e.g. a managing director or other whole-time director) by virtue of his employment would be taxable as his income from salary. Thus, income by way of remuneration received by a managing director would be taxable as his salary income whereas the income received by him as director's fees in his capacity as director for attending the meetings of the Board would be assessable under the head "Income from other sources".

(iii) An official liquidator appointed by the Court or by the Central Government would also become an employee of the Central Government under Section 448 of the Companies Act, 1956 and consequently the remuneration due to him would also be assessable under the head 'Salaries'.

(iv) Remuneration received by a manager of a company even if he is wrongly designated as a director or by any other name would be chargeable to tax under this head regardless of the fact that the amount is payable to him monthly or is calculated at a certain percentage of the company's profits.

(v) Salary paid to a partner by a firm is nothing but appropriation of profits. Any salary, bonus, commission, or remuneration by whatever name called due to or received by partner of a firm shall not be regarded as salary but has to be charged as income from business. It is because of the fact that the relationship between the firm and its partner is not of employer and employee.

(vi) According to a circular of the Board dated 22-5-1967, the salary received by a person as Member of Parliament will not be chargeable to income-tax under the head "Salaries" but as "Income from other sources" because a Member of Parliament is not an employee of the Government but only an elected representative of the people.

(vii) The income received by a treasurer of a bank would be taxable as his salary income if the treasurer is an employee of the bank. If he does not happen to be an employee, the income received by him would be taxable as "Income from other sources". For this purpose, the question

whether in a particular case the treasurer is an employee or not has to be decided on the basis of the facts and circumstances of each case having due regard to his powers, responsibilities and functions.

(viii) Income derived by any person from carrying on a profession or vocation must be taxed as business income and not as salary income because employment is different from profession.

But, if an employee receives any money from his employer as part of the terms of employment for not carrying on any profession, such income must be taxed as salary income. For instance, the allowance given by employer to a doctor employed by him for not carrying on a profession in addition to the employment would be income arising from employment in accordance with the terms and conditions of such employment and must, therefore, be taxed as salary income. If an employee gets money from persons other than his employer and if such money is not in any way related to the contract of services with the employer under whom he is working, the receipts, if taxable as income, must be assessed under the head "Income from other sources".

However, gratuity, bonus, commission or other items of payment made by the employer without any specific stipulation in the contract of employment to this effect, would still be taxable as salary, because they are paid by the employer for the services rendered by the employee. The fact that such payments are voluntary and in certain circumstances may qualify for exemption from income-tax in the hands of the employee, would not affect the income being computed under the head salary.

SALARY RECEIVED FROM FORMER EMPLOYER

Even salaries received by an employee from former employer(s) for services rendered would be chargeable to tax under this head. Hence, the fact that the employee in question is not an employee under the person from whom the money is received at the time of its receipt, is irrelevant. Arrears of salaries are chargeable to tax as the income of the year in which such arrears are received if they are not charged to tax at the time of becoming due.

Other points for consideration for taxability of salary

(1) Any lump sum amount paid to an employee by his employer in commutation, reduction or substitution of salary, pension or other type of income from employment, is nevertheless taxable as income from salary in the year in which such payment falls due or is received by the employee, whichever is earlier.

Section 200 of the Companies Act totally prohibits any company from paying tax-free remuneration to any of its employees.

(2) For purposes of computing the income taxable under this head, the gross salary due to the employee should be taken as the basis. Thus, any tax deducted at source or other deductions on account of provident fund, insurance premium, or on any other account made by the employer from the salary income, should be added to the net salary received by the employee. The fact that some of the deductions like provident fund or insurance premium may qualify for any deduction from gross total income in the personal assessment of the employee, does not, in any way, affect the quantum of salary due to the employee.

(3) Any salary voluntarily surrendered by the employee on or after 1- 4-1961 to the Central Government under the provisions of the Voluntary Surrender of Salaries (Exemption from Taxation Act), 1961, would not be treated as income taxable in the hands of the employee. In all other cases, the salary foregone voluntarily or otherwise surrendered by the employee, would still be chargeable to tax although the employee may not receive that income. No tax exemption is available for surrender of salaries for the simple reason that the amount surrendered constitutes merely an application of income which is immaterial for the purpose of taxing the employee.

If the foregoing or surrender of salary represents a donation for charitable purpose, the employee may qualify for deduction from gross total income under Section 80G of the Act. However, salary foregone before it becomes due cannot be taxed [C.I.T. v. Mehar Singh Sampuran Singh Chawla (1973) 90 ITR 219]. Further, where in reality there is no agreement to pay any salary, the apparent foregoing of a fictional salary would not attract tax.

(4) Where a person, out of missionary spirit, agrees to work as principal in an institution without accepting any salary from the institution, and in the school accounts his salary is shown as an item of expenditure, while the same amount is entered in the receipts as a donation by the management in a separate cash book meant for exclusive use for the management only, these entries are book entries only and no money is actually paid to him; hence, taking into consideration the special circumstances of the case, the fictional salary would not be taxable [Reade v. Brearley (1933) 17 TC 687].

(5) Salary is taxable even if the money is not received or could not be recovered from the employer due to his insolvency or any other reason. The expenses, if any, incurred by the employee to take legal proceedings against his employer for its recovery would not also be allowed as a deduction from the income assessable in his hands. This is because of the fact that the actual receipt of the income is immaterial for purpose of its taxation.

(6) It is immaterial whether the employer is Government or a private employer. Further, the salary may be paid by a foreign Government to its employees serving in India, and this salary is taxable under the head "Salaries".

(7) The leave salary paid to the legal heirs of the deceased employee in respect of privilege leave standing to the credit of such employee at the time of his/her death is not taxable as salary. It is an 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).

SALARY [SECTION 17(1)]

"Salary" includes :

(i) Wages or Salary: 'Salary' is generally used in respect of payment for services of a higher class, whereas 'wages' is confined to the earnings of labourers. However, for income-tax purposes there is no difference between salary and wages.

(ii) Annuity is annual grant made by the employer to the employee.

(iii) Pension is a periodical payment for past services.
(iv) Gratuity is a lump sum payment for past services.
(v) Fees and Commission: It is a remuneration to encourage employees.
(vi) Perquisites: These include all benefits and amenities provided by the employer to the employee, either in cash or kind.
(vii) Profit in lieu of or in addition to salary or wages.
(viii) Advance of Salary.
(ix) Any payment received by an employee in respect of any period of leave not availed of by him.
(x) Taxable portion of annual accretion: Where the employee is a member of a Recognised Provident Fund, the amount contributed by the employer in this fund in excess of 12 per cent of the salary of the employee and interest credited on the amount of the fund in excess of the prescribed rate of interest is to be included in the salary income.
(xi) Taxable portion of transferred balance: When an unrecognised provident fund is recognised for the first time, the balance in the unrecognised provident fund is known as "Transferred balance". The employer's share (contribution in unrecognised provident fund and interest on employer's share) is included in the salary income for income-tax purposes at the time of such transfer.
(xii) The contribution made by the Central Government in the previous year, the account of any employee under a pension scheme referred to in Section 80CCD.

Important Notes :

(1) Advance salary is taxable on receipt basis in the previous year in which it is received. The recipient can, however, claim relief under Section 89(1) read with Rule 21A.
(2) Arrears salary is taxable on receipt basis subject to the fact that it has not been taxed on accrual basis earlier. The recipient can claim relief in terms of Section 89(1) read with Rule 21A.
(3) Encashment of leave salary (before retirement) is taxable on receipt basis but relief can be claimed under Section 89(1). However, such salary received at the time of retirement is exempt subject to Section 10(10AA).
(4) Pension received by a person from the employer after his retirement is taxed as salary. The pension can be either uncommuted or commuted. Commuted pensions received by government employees are wholly exempt under Section 10(10A). In case of non-Government employees, commuted value of one-third of pension which he is normally entitled to receive is exempt from tax if the employee receives gratuity. In other cases, one-half of commuted value of pension is exempt.
(5) Instalments re-paid under Additional Emoluments (C.D.) Act, 1974 are taxable as arrear of salary in the previous year in which the same are received. However, relief under Section 89(1) can be claimed.

ALLOWANCES

An allowance is defined as a fixed amount of money given periodically in addition to the salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employment. It is taxable on due/accrued basis whether it is paid in addition to the salary or

in lieu thereon. These allowances are generally taxable and are to be included in the gross salary unless a specific exemption has been provided in respect of allowances provided under the following sections:
(a) House Rent Allowances – Section 10(13A): Covered under Unit 3.
(b) Special Allowance – Section 10(14)(i) & (ii): Covered under Unit 4.

Fully Taxable Allowances

(1) **Dearness Allowance, Additional Dearness Allowance and Dearness Pay:** This is a very common allowance these days on account of high prices. Sometimes Additional Dearness Allowance is also given. It is included in the income from salary and is taxable in full. Sometimes it is given under the terms of employment and sometimes without it. When it is given under the terms of employment it is included in salary for purposes of determining the exemption limits of house rent allowance, recognised provident fund, gratuity and value of rent free house and is also taken into account for the purposes of retirement benefits.

Sometimes dearness allowance is given as 'Dearness Pay'. It means that it is being given under the terms of employment.

(2) **Fixed Medical Allowance:** It is fully taxable.

(3) **Tiffin Allowance:** It is given for lunch and refreshments to the employees. It is taxable.

(4) **Servant Allowance:** It is fully taxable even if it is given to a low paid employee, not being an officer, i.e., it is taxable for all categories of employees.

(5) **Non-practising Allowance:** It is generally given to those medical doctors who are in government service and they are banned from doing private practice. It is to compensate them for this ban. It is fully taxable.

(6) **Hill Allowance:** It is given to employees working in hilly areas on account of high cost of living in hilly areas as compared to plains. It is fully taxable, if the place is located at less than 1,000 metres height from sea level.

(7) **Warden Allowance and Proctor Allowance:** These allowances are given in educational institutions for working as Warden of the hostel and/or working as Proctor in the institution. These allowances are fully taxable.

(8) **Deputation Allowance:** When an employee is sent from his permanent place of service to some other place or institution or organisation on deputation for a temporary period, he is given this allowance. It is fully taxable.

(9) **Overtime Allowance:** When an employee works for extra hours over and above his normal hours of duty he
is given overtime allowance as extra wages. It is fully taxable.

(10) **Other Allowances** like Family allowance, Project allowance, Marriage allowance, City Compensatory allowance, Dinner allowance, Telephone allowance etc. These are fully taxable.

Allowances not fully taxable

(a) **Special allowances for performance of official duty [section 10(14)(i)]:** These allowances are specifically granted to meet expenses wholly and exclusively incurred in the performance of official duty. These are exempt to the extent such expenses are actually incurred or the

amount received whichever is less. These allowances are Travelling allowance, Daily allowance, Helper allowance, Academic Allowance, Uniform Allowance etc. All these allowances are **discussed in detail under Unit 3.**

(b) **Allowance to meet personal expenses :**

– Allowances which are granted to meet personal expenses are exempt to the extent of amount received or the limits specified whichever is less. These allowances are Children education allowance, Hostel Expenditure allowance, Tribal area, Schedule area/agency area allowance, special compensatory hilly area allowance or high altitude allowance etc., Border area, remote area allowance or disturbed area allowance etc., Compensatory, modified field area allowance, Counter insurgency allowance granted to members of armed forces, Transport allowance etc. These allowances are discussed in detail in Unit 3.

– Allowances which are granted to meet personal expense are exempt to the fixed percentage of amount received. These allowances are allowed to transport employees working in any transport system.

Treatment of Entertainment Allowance

In case of Entertainment allowance an assessee will not get any exemption but would be eligible for deduction under section 16(ii) from gross salary. The deduction is allowed to government employees only; Non- Government employees will not be eligible for this deduction. The entire amount of entertainment allowance will be added to gross salary.

The minimum of the following shall be available as deduction in case of Government employees:

(i) Actual amount of entertainment allowance received during the year

(ii) 20% of his salary exclusive of any allowance, benefit or other perquisites.

(iii) `5,000.

PERQUISITES [SECTION 17(2)]

The term "perquisites" includes all benefits and amenities provided by the employer to the employee in addition to salary and wages either in cash or in kind which are convertible into money. These benefits or amenities may be provided either voluntarily or under service contract. For income-tax purposes, the perquisites are of three types:

(A) Tax-free perquisites

(B) Taxable perquisites

(C) Perquisites taxable under specified cases.

The term "Perquisite" is defined by section 17(2) as follows:

(i)the value of rent-free accommodation provided to the assessee by his employer;

(ii) the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer;

Provided further that for the assessment year beginning on the 1st day of April, 2002, nothing contained in this clause shall apply to any employee whose income under the head "Salaries" (whether due from, or paid or allowed by, one or more employers) exclusive of the value of all perquisites not provided for by way of monetary payment, does not exceed one lakh rupees.

Explanation. – For the purposes of clause (2), –

(i) "hospital" includes a dispensary or a clinic or a nursing home;
(ii) "family", in relation to an individual, shall have the same meaning as in clause (5) of section 10; and
(iii) "gross total income" shall have the same meaning as in clause (5) of section 80B;

(A) Tax-free perquisites (in all cases)

The value of the following perquisites is not to be included in the salary income of an employee :

(i) **Medical Facilities:**

(a) The value of any Medical facility provided to an employee or his family member in any hospitals, clinics, etc. maintained by the employer.
(b) Reimbursement of expenditure actually incurred by the employee on medical treatment for self or for his family members in any hospitals, dispensaries etc. maintained by the Government or local authority or in a hospital approved under the Central Health Scheme or any similar scheme of the state Government or in a hospital, approved by the chief commissioner having regard to the prescribed guidelines for the purposes of medical treatment of the prescribed diseases or ailments.
(c) Group medical insurance obtained by the employer for his employees (including family members of the employees) or all medical insurance payments made directly or reimbursement of insurance premium to such employees who take such insurance.
(d) Reimbursement of medical expenses actually incurred by the employee upto a maximum of ` 15,000 in the aggregate in a year, in a private hospital for his and his family.
(e) Any expenditure incurred or paid by the employer on the medical treatment of the employee or any family member of the employee outside India, the travel and stay abroad of such employee or any family member of such employee or any travel or stay abroad of one attendant who accompanies the patient in connection with such treatment will not be included in perquisites of the employee. However, the travel expenditure shall be excluded from the perquisites only when the employee's gross total income as computed before including the said expenditure does not exceed two lakh rupees and further to such conditions and limits as the Board may prescribe having regard to guidelines, if any, issued by the Reserve Bank of India.

(ii) **Refreshment :**

The value of refreshment provided by the employer during office hours and in office premises is fully exempt. Free Meals provided by the employer during working or business hours or through paid non transferable (usable only at eating joints) voucher if its value thereof in either case does not exceed `50 will not be treated as income of the employee. However, free meals provided by the employer during working hours in a remote area or an offshore installation shall be fully exempt.

(iii) **Subsidized lunch or dinner provided by employer:**

With effect from assessment year 1996-97, expenditure incurred by employer on provision of food or beverages to employees either inside or outside the place of work during working hours upto ` 35 per day per employee will not be treated as income of the employee provided the

amount is paid by the employer directly to the caterer, restaurant, eating place, canteen, etc. (Circular: Nos. 708, dated 18.7.1995 and 727, dated 27.10.1995 issued by CBDT).

(iv) **Recreational facilities:**

The value of recreational facilities provided is exempt. However, the facility should not be restricted to a selected few.

(v) **Telephone facility** provided at the residence of the employee is exempt to the extent of the amount of telephone bills paid by the employer when it is used for official and personal purposes of the employee.

(vi) **The value of transport** provided by the employer to the employees as a group (and not to any individual or a few employees alone) from their place of residence to the place of work and back in the case of an employer engaged in the business of carriage of goods or passengers, to his employees either free of charge or at a concessional rate. Also from the assessment year 1990-91, conveyance facility provided for the journey between office and residence and back at free of charge or at concessional rate.

(vii) **Personal accident insurance:** Payment of annual premium by employer on personal accident policy effected by him to his employee.

(viii) **Refresher Course:** Where the employee attends any refresher course in management and the fees are paid by the employer, the amount spent by employer for the purpose.

(ix) **Free rations:** The value of free rations given to the armed forces personnel.

(x) **Family planning:** The amount spent by an employer on the promotion of family planning amongst its employees.

(xi) **Sale of an asset** (being a movable asset but other than car, electronic items) or gift of such asset to an employee after using the same by the employer for 10 years or more is a perquisite in the hands of employee.

(xii) Perquisites to Government employees being citizens of India, posted abroad.

(xiii) **Rent-free house** to High Court Judges [High Court Judges (Conditions of Service) Act, 1954].

(xiv) **Rent-free house** to Supreme Court Judges [Supreme Court Judges (Conditions of Service) Act, 1958].

(xv) **Conveyance facility** to High Court and Supreme Court judges.

(xvi) **Privilege passes and privilege ticket** orders granted by Railways to its employees.

(xvii) Sum payable by an employer through a Recognised Provident Fund or an Approved Superannuation Fund or Deposit-linked Insurance Fund established under the Coal Mines Provident Fund or the Employees' Provident Fund.

(xviii) Sum payable by an employer to pension or deferred annuity scheme.

(xix) Employer's contribution to staff group insurance scheme.

(xx) **Actual travelling expenses** paid/reimbursed by the employer for journeys undertaken by employees for business purposes.

(xxi) **Leave travel concession** exempt as per provision of Section 10.

(xxii) **Free holiday trips** to non-specified employees.
(xxiii) **Rent-free furnished residence** (including maintenance thereof) provided to an Officer of Parliament, a Union Ministry and a leader of opposition in Parliament.
(xxiv) **Goods sold to employees**, by their employer, at concessional rates.
(xxv) **The value of any benefit** provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under the Employees' Stock Option Plan or Scheme of the said company.
(xxvi) **Free educational facility** to the children of the employee in an educational institute owned/maintained by the employer if cost of such education or value of such benefit does not exceed ` 1,000/- per month per child.
(xxvii) **Interest free loan** to an employee if the amount of loan does not exceed ` 20,000/- or if loan is provided for specified diseases.
(xxviii) **Computer/laptops** (provided only for use, ownership is retained by the employer). One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payment to which the employee has no right till the contingency occurs.

(B) Taxable perquisites (in all cases)

The value of the following perquisites is added to the salary income of the employee:
(i) Value of rent-free residential accommodation provided to the assessee (except to the Judge of a High Court or Supreme Court; an Officer of Parliament, a Union Minister and a leader of opposition in Parliament).
(ii) Value of any concession in the matter of rent in respect of residential accommodation provided to the assessee.
(iii) Sum paid by the employer (directly or indirectly) for effecting an assurance on the life of the employee or for providing an annuity. If the amount is paid to a recognised provident fund or an approved superannuation fund, or to a deposit linked insurance fund established under the Coal Mines Provident Fund Act or Employees' Provident Fund Act, the sum so paid is not to be included in the salary income.
(iv) Sum paid by the employer in respect of any obligation of the assessee, which would otherwise have been payable by the assessee. Some of the examples of such expenses are as follows :
(a) Income-tax paid by the employer due from the employee.
(b) Payment of club bills, club subscription or hotel bills of the employee.
(c) Fees paid by the employer directly to the school or reimbursement of tuition fees of the children of the employee.
(d) Payment of any loan due to the employee.
(v) The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.
(a) "specified security" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 and, where

employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme;

(b) "sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;

(c) the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from the assessee in respect of such security or shares;

(d) "fair market value" means the value determined in accordance with the method as may be prescribed;

(e) "option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price;

(vi) The amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds one lakh rupees;

(vii) The value of any other fringe benefit or amenity as may be prescribed.

(C) Perquisites taxable only in the cases of Specified Employees

The value of certain benefit or amenity granted or provided free of cost or at a concessional rate in any of the following cases only shall be included in the salary income:

(a) by a company to an employee who is director thereof [It is immaterial whether the director is full time or part time director];

(b) by a company concern to an employee, being a person who has a substantial interest in the company concern, i.e., employee is the beneficial owner of at least 20 per cent of the equity shares of that company or is entitled to atleast 20 per cent share is profit of the concern;

(c) an employee whose income chargeable under head salaries (exclusive of the value of all benefits or amenities not provided by way of monetry payments) excess ` 50,000, is a specified employed. Some of the examples of such perquisite which are included in the salary income of a specified employee as defined above are:

(i) Free boarding facility provided by employer.

(ii) Free conveyance for private use.

(iii) Free education facility to the family members of employee.

(iv) Holiday trips at employer's cost.

(v) Gas, electricity or water supplied free for household consumption.

(vi) Wages of domestic servants paid by employer.

(vii) Free lunches or dinners.

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)]

Valuation of perquisite in respect of motor car

The valuation of perquisite in respect of motor car provided to the employee shall be calculated in different situations in different ways such as car may be used by the employee wholly for business use or used partly for personal use or partly for business use. The calculation of value of perquisites is shown in this table as follows:

1. WHERE CAR IS OWNED BY THE EMPLOYEE A. It is not a perquisite, hence not taxable.

A. When car expenses are met by the employee B.(i) in this case, no value of perquisite shall be

B. When running and maintenence expenses are added provided the employer has maintained met or reimbursed by the employer complete documents of journey undertaken.

(i) If the car is used wholly for official B. (ii) v alue of perquisite shall be actual purposes expenditure incurred by the employer **less**

(ii) If the car is used wholly for private amount recovered from the employee. purposes

B. (iii) Value of perquisite shall be actual

(iii) If the car is partly used for official expenditure incurred by the employer **less** purposes and partly for private purposes. amount used for official purposes i.e @1800 per month where the cubic capacity of the engine

does not exceed 1.6 litres or `2400 if such capacity exceeds 1.6 litres and `900 p.m if chauffeur is provided or higher amount as per records of the employer **less** amount recovered from the employee.

2. WHEN CAR IS OWNED OR HIRED BY EMPLOYER

A. When running and maintenance expenses A.(i) in this case, no value of perquisite shall be are met or reimbursed by the employer added provided the employer has maintained

(i) If the car is used wholly for official complete documents of journey undertaken. purposes

(ii) Value of perquisite shall be the actual (ii) If the car is used wholly for private expenditure incurred by the employer plus normal purposes wear and tear @10% or hire charges if car is

(iii) If the car is partly used for official taken on hire **less** amount recovered from the purposes and partly for private purposes. employee.

B. When running and maintenance expenses of A.(iii) value of perquisite shall be `1800 p.m car are met by the employee where the cubic capacity of the engine does not (i) If the car is used wholly for official exceed 1.6 litres or `2400 p.m if such capacity purposes exceeds 1.6 litres and `900 p.m if chauffeur is (ii) If the care is used wholly for private provided. purposes

B. (i) It is not a perquisite, hence not taxable.
(iii) If the car is partly used for official B. (ii) Value of perquisite shall be 10% of the purposes and partly for private purposes. actual cost of car or hire charges if car is taken on hire plus salary of chauffeur if any paid or payable by the employer.

B. (iii) value of perquisite shall be `600 p.m where the cubic capacity of the engine does not exceed
1.6 litres or `900 p.m if such capacity exceeds 1.6 litres and `900 p.m if chauffeur is provided.

Sweeper, Gardener, Watchman or a Personal Attendant (Sub-rule 3)

The value of benefit to the employee or any member of his household resulting from the provision of the employer of services or a sweeper, a gardener, a watchman or personal attendant, shall be the actual cost to the employer. The actual cost in such a case shall be the total amount of salary paid or payable by the employer or any other person on his behalf for such services as reduced by any amount paid by the employee for such services.

Gas, Electric Energy or Water (Sub-rule 4)

The value of benefit to the employee resulting from the supply of gas, electric energy or water for his household consumption shall be determined as the sum equal to the amount paid on that account by the employer to the agency supplying the gas, electric energy or water. Where such supply is made from the sources owned by the employer, without purchasing them from any other outside agency, the value of perquisites would be the manufacturing cost per unit incurred by the employer. Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value so arrived at.

Free or Concessional Education (Sub-rule 5)

The value of benefit to the employee resulting from the provision of free or concessional educational facilities for any member of his household shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf of where the educational institution is itself maintained and owned by the employer or where free educational facilities for such member of employees' household are allowed in any other educational institution by reason of his being in employment of that employer, the value of the perquisite to the employee shall be determined with reference to the cost of such education in similar institution in or near the locality.

Where any amount is paid or recovered from the employee on that account, the value of benefit shall be reduced
by the amount so paid or recovered.

Provided that where the educational institution itself is maintained and owned by the employer and free educational
facilities are provided to the children of the employee or where such free educational facilities are provided in
any institution by reason of his being in employment of that employer, nothing contained in this sub-rule shall
apply if the cost of such education or the value of such benefit per child does not exceed ` 1,000 p.m.

Other fringe benefits or amenities (Sub-rule 7)

In terms of provisions contained in sub-clause (vi) of Sub-section (2) of Section 17, the following other fringe benefits or amenities are hereby prescribed and the value thereof shall be determined in the manner provided thereunder;

(i) Interest free or concessional loan

The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan made available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the simple interest computed at the rate charged by the State Bank of India in respect of loans for house and conveyance and at the rate charged by the State Bank of India for other loans on the maximum outstanding monthly balance as reduced by the interest, if any, actually paid by him or any such member of his household.

However, no value would be charged if such loans are made available for medical treatment in respect of diseases specified in rule 3A of these rules or where the amount of loans are petty not exceeding in the aggregate ` 20,000. Provided that where the benefit relates to the loans made available for medical treatment referred to above the exemption so provided shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.

(ii) Use of any movable asset

The value of benefit to the employee resulting from the use by the employee or any member of his household of any movable asset (other than assets already specified in this rule and other than laptops and computers) belonging to the employer or hired by him shall be determined @ 10% p.a. of the actual cost of such asset or the amount of rent or charge paid or payable by the employer, as the case may be, as reduced by the amount, if any, paid or recovered from the employee for such use.

(iii) Transfer of any movable asset

The value of benefit to the employee arising from the transfer of any movable asset belonging to the employer directly or indirectly to the employee or any member of his household shall be determined to the amount representing the actual cost of such asset to the employer as reduced by the cost of normal wear and tear calculated at the rate of 10% of such cost for each completed year during which such asset was put to use by the employer and as further reduced by the amount, if any, paid or recovered from the employee being the consideration for such transfer. Provided that in the case of computers and electronic items, the normal wear and tear would be calculated at the rate of 50% and in the case of motor cars at the rate of 20% by the reducing balance method (WDV).

Explanation to the Rule 3

Meaning of certain terms mentioned in rules for valuation of perquisites:

(i) **"accommodation**" includes a house, flat, farm house or part thereof, or accommodation in a hotel, model, service apartment, guest house, caravan, mobile home, ship or other floating structure;

(ii) **"entertainment"** includes hospitality of any kind and also expenditure on business gifts other than free samples of the employer own product with the aim of advertising to the general public;
(iii) **"hotel"** includes licensed accommodation in the nature of motel, service apartment or guest house;
(iv) **"member of household"** shall include:
(a) spouse(s)
(b) children and their spouses
(c) parents
(d) servants and dependants;
(v) **"remote area",** for the purposes of proviso to this sub-rule means an area that is located at least 40 kilometers away from a town having a population not exceeding 20,000 based on latest published all India census;
(vi) **"salary"** includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called from one or more employers, as the case may be but does not include the following, namely:
(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;
(vii) **"maximum outstanding monthly balance"** means the aggregate outstanding balance for each loan as on the last day of each month.

PROFITS IN LIEU OF OR IN ADDITION TO SALARY

Under this the following items are included :

(i) The amount of any compensation due to or received by an assessee from the employer or former employer at or in connection with the termination of his employment. The 'termination of employment' means retirement, premature termination of employment, termination by death or voluntary resignation. Generally, under the Income tax
Act, the income that is chargeable to tax is only a receipt which is revenue in nature; receipts of a capital nature are not chargeable to tax but this provision constitutes an exception to this rule because compensation received by an employee for termination of his employment would be a capital receipt since it is received in replacement of the sources of income itself. Still it is chargeable to tax because of the specific provision in the Act. However, relief under Section 89(1) would be available to the assessee in cases where he gets money which represents a profit in lieu of salary.
The amount of any compensation due to or received by any assessee from his employer in connection with the modification of the terms and

conditions relating to employment. For example, where an employer wants to cut down the salary payable to the employee, the lump sum paid to compensate the employee shall be treated as profits in lieu of salary. In the same way, where the remuneration for services is paid at the end of the period of employment or a lump sum remuneration is paid at the beginning of employment for a number of years, such payment shall be treated as profits in lieu of salary.

(ii) Any amount due to or received, whether in lump sum or otherwise, by any assessee from any person - (A) before his joining any employment with that person; or (B) after cessation of his employment with that person. (iii) Any payment other than the following payment due to or received by assessee from an employer or a former employer or from a provident or other fund, to the extent to which it does not consist of contribution by the assessee or interest on such contributions by the assessee or interest on such contributions or any sum under keyman Insurance Policy.

(1) Gratuity

Exceptions : The following shall not be included in the salary income :

(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 "Income which do not Form part of total income" in Unit 3.

(2) Commuted value of pension

(a) In case of Government employees (Central, State, Local authority or statutory corporation), the full amount of commuted value of pension is exempted.

(b) In case of non-Government employees, the exemption is as follows :

(i) where the employee receives any gratuity, the commuted value of one-third of the pension which he is normally entitled to receive;

(ii) where the employee does not receive any gratuity, the commuted value of one-half of such pension.

(3) Retrenchment compensation

Retrenchment compensation received by a workman under the Industrial Disputes Act, 1947 or any other Act or rules, orders or notifications issued thereunder or under any standing orders or under any award, contract of service or otherwise to the extent of the actual award or ` 5,00,000 the amount notified by the Central Government or the amount calculated u/s 25F(b) of the Industrial Disputes Act, 1947 whichever is less.

(4) Amount received from Statutory Provident Fund and/or Public Provident Fund/Recognised Provident Fund

The amount is exempt if the following conditions are satisfied :

(i) he has rendered a continuous service with his employer for five years or more; or

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

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

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

(5) House rent allowance received from the employer

The exempted amount shall not exceed :

(a) actual amount of such allowance received in respect of the relevant period; or

(b) excess of rent paid or payable by the employee over ten per cent of salary (salary includes dearness allowance, if the terms of employment so provide, (and also commission if based on percentage on sales/turnover) but excludes all other allowances and perquisites) due in respect of the relevant period; or

(c) an amount equal to –

(i) Where such accommodation is situated at Mumbai, Calcutta, Delhi or Chennai, 50% of the amount of salary due to the assessee in respect of the relevant period; and

(ii) Where such accommodation is situated at any other place, 40% of the amount of salary due to the assessee in respect of the relevant period;

(6) Remuneration for extra duties and voluntary payments to employees made by an employer, if such payments are made in reference to services rendered by virtue of employment, also constitutes profits in lieu of salary.

Note: For details, see "Incomes which do not form part of income" in Unit 3.

DEDUCTIONS ALLOWED FROM SALARIES (SECTION 16)

The following amounts shall be deducted in order to arrive at the chargeable income under the head 'Salaries'.

(A) Standard deduction: Omitted by Financial Act, 2005 w.e.f. 1.4.2006. – Section 16(i)

(B) Entertainment allowance : Where the employee is in receipt of entertainment allowance, the amount so received shall first be included in the salary income and thereafter the following deduction shall be made - Section 16(ii) :

16(ii). A deduction in respect of any allowance in the nature of an entertainment allowance specifically granted by an employer to the assessee who is in receipt of a salary from the Government, a sum equal to onefifth of his salary (exclusive of any allowance, benefit or other perquisite) or five thousand rupees, whichever is less.

W.e.f. April 1, 2002 entertainment allowance will be allowed in computing income from salary only in case of employees of the Government and will cease to be allowable for persons other than those employed in Government i.e. entertainment allowance deduction will not be allowed to other employees.

Note: For this purpose 'Salary' excludes any allowance, benefit or other perquisites: Where an employee, not entitled to claim deduction under this clause, spends some money on the entertainment of customers of the concern, the amount so spent cannot be deducted from the salary income. The condition makes exemption well-nigh impossible for the employees of private sector. For them, the better course would be to get the entertainment expenses reimbursed.

(C) Tax on employment or Professional Tax: From the assessment year 1990-91, deduction shall be allowed in respect of any sum paid by the assessee on account of a tax on employment within the meaning of clause (2) of article 276 of the Constitution, leviable by a State under any law passed by its legislature.

Where Professional/Employment tax is paid by the employer on behalf of the employee, it will first be included in his gross salary as a perquisite, being a monetary obligation of the employee discharged by the employer. Thereafter, a deduction on account of such professional tax shall be allowed to the employee from his gross salary. Professional tax due but not paid shall not be allowed as deduction.

PROVIDENT FUNDS - TREATMENT OF CONTRIBUTIONS TO AND MONEY RECEIVED FROM THE PROVIDENT FUND

For purposes of Income-tax, provident funds are grouped under three heads:

(A) Statutory provident fund

All provident funds which are set up under the Provident Funds Act, 1925 are called Statutory Provident Funds. Provident funds of institutions such 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 deduction under Section 80C of the Income-tax Act. [Salary for this purpose, includes basic salary; dearness allowance/pay (if the terms of employment so provide) and commission (if based on a fixed percentage of turnover achieved by the employee)]. As regards interest on the contributions to the Provident Fund, only an amount exceeding a sum calculated at 12% per annum on the balance standing to the credit of the employee would be treated as part of the taxable income of the employee. In other words, so long as the amount of interest does not exceed this limit, the interest does not become chargeable to tax in the hands of the employee.

(C) Unrecognised provident Fund

The Provident Fund which is neither Statutory nor recognised by the Commissioner of Income-tax nor Public Provident Fund, would be an Unrecognised Provident Fund for income-tax purposes. In the case of an Unrecognised Provident Fund, the employee's own contribution to the Fund would not be allowed as a deduction. The employer's contribution and the interest thereon would, however, be exempt from tax as and when the contributions are being made. But when the money in lump

sum is received back by the employee, that part of the amount attributable to the employer's contribution would be taxable as income from salaries and the interest on the employer's contribution would also be taxable as salary income in the hands of the employee. The employee's own contributions when received back would not be taxable because they do not contain an element of income. However, the interest thereon would be chargeable to tax as income from other sources and not as income from salaries.

INCOMES EXEMPT FROM TAX AND NOT INCLUDIBLE IN 'SALARY'

The following items relevant to salaries have been discussed under Incomes which do not form part of total income at Unit 3 of this material and are exempt from tax, subject to the limits applicable for each:

1. Leave Travel Allowance [Section 10(5)];
2. Remuneration of a person who is not a citizen of India [Section 10(6)].
3. Allowances payable outside India [Section 10(7)];
4. Remuneration of an employee working under the Co-operative Technical Assistance Programme [Section 10(8)];
5. Death-cum-retirement gratuity [Section 10(10)];
6. Amount received in commutation of Pension [Section 10(10A)];
7. Encashment of earned leave [Section 10(10AA)];
8. Retrenchment compensation [Section 10(10B)];
9. Payment received from Statutory Provident Fund [Section 10(11)];
10. Payment received from a recognised Provident Fund [Section 10(12)];
11. Payment received out of an approved Superannuation Fund [Section 10(13)];
12. House rent allowance [Section 10(13A)];
13. Special allowances to meet the expenses of the duties [Section 10(14)];
14. Salary income of a member of Scheduled Tribe [Section 10(26)];
15. Salary income of a resident of Ladakh [Section 10(26A)];

Tax Deducted at Source

Salaries payable by an employer are chargeable to tax in the hands of the employee and are subject to deduction of tax at source under Section 192 of the Income-tax Act. The obligation of the employer to deduct tax at source is mandatory and cannot be negotiated. But in cases where there is any failure on the part of the employer to deduct the tax at source, the employee cannot escape liability to tax; he would be chargeable to tax on his entire income from salaries. The fact that the employer could be proceeded against and be subjected to penalty or prosecution, would not absolve the employee of his liability to pay tax on the income which should have been subjected to deduction of tax by the employer. In every case, the tax deducted by the employer should be added to the employee's income and the gross amount should be taken as the taxable income of the employee.

Income under the head House Property

Income from house property is one of the important heads of income under the Income Tax Act. The tax payers have been, in particular, keen to know about the exemptions and deductions available to them on repayment of interest and principal of the loan obtained to purchase the house property, if that house property is let out or self-occupied. The amount of interest on borrowed capital of the current year is available under the head house property further repayment of principal is available under section 80C to individuals and Hindu Undivided Families.

BASIS OF CHARGE

Section 22 of the Act provides as follows: "The annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax, shall be chargeable to Income tax under the head Income from House Property".

The following points emerge from the above charging section:

(a) Tax is charged on income from the buildings or lands appurtenant thereto:

The buildings include residential buildings, buildings let out for business or profession or auditoriums for entertainment programmes. The location of the building is immaterial. It may be situated in India or abroad.

(b) Tax is charged on income from lands appurtenant to buildings :

Where the land is not appurtenant to a building the income from land can be charged as business income or "income from other sources", as the case may be. The lands appurtenant to buildings include approach roads to and from public streets, courtyards, motor garage, compound, play-ground and kitchen garden. In case of non-residential buildings, car-parking spaces, drying grounds or play-grounds shall be the lands appurtenant to buildings.

(c) Tax is charged from the owner of the buildings and land appurtenant thereto:

Where the recipient of the income from house property is not the owner of the building, the income is not chargeable under this head but under the head 'Income from Business or Other Sources'. For example, the income to a lessee from sub-letting a house or income to a mortgagee from house property mortgaged to him is not chargeable under the head 'Income from House Property'. The owner of the buildings may be the legal owner or beneficial owner. In ownership, the ownership of building is considered and not the ownership of income. In certain cases the income may not be received by the owner of the building, still he shall be liable to tax because he is the owner of the building.

Deemed ownership

As per section 27, the following persons though not the legal owners of a property are deemed to be the owners for the purposes of sections 22 to 26:

(i) Transfer to a spouse or minor child:

an individual who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in

connection with an agreement to live apart, or to a minor child not being a married daughter;

(ii) Holder of an 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.

Other points with regard to ownership

(i) Official assignee or receiver : Where the owner of the property becomes insolvent,the official assignee or receiver under the law of insolvency shall be chargeable in respect of the income from such house property as the owner. However, the receiver appointed by the Court shall not be deemed to be the owner of the insolvent's property, because the property does not vest in him.

(ii) Ownership in dispute : Where the title to the property is in dispute, the Assessing Officer is empowered to decide the ownership of the property for income-tax purposes. However, where the decision of the Court is contrary to the Assessing Officer's decision, the decision of the court will prevail and he will reassess the assessee accordingly.

(iii) Co-owners of the property : Where the property is owned jointly by two or more persons and their respective shares are definite and ascertainable, they shall be assessed individually on their shares in the income from the property (Section 26).

(iv) Owner in the previous year : Since tax is levied only on the income of previous year, annual value of property owned by a person during the previous year, is taxable in the following assessment year, even if the assessee is not the owner of the property during the assessment year.

(v) Status of property in a foreign country : A resident assessee is taxable under Section 22 in respect of annual value of a property situated in a foreign country. But, a resident but not ordinarily resident or non-resident is chargeable under Section 22 in respect of income of a house property situated abroad, only if income is received in India during the previous year. In such cases where tax incidence is attracted, the annual value is computed as if the property is situated in India.

(d) Utilised by the assessee for his own business or profession purpose

The annual value of such property or the portion thereof as is utilised by the assessee for the purposes of his own business, profession or vocation, the profits of which are assessable to tax, is not taxable under Section 22. The assessee is also not allowed to claim any deduction in respect of notional rent while computing income from any such business, profession or vocation. However, the assessee can claim depreciation under Section 32 of the Income-tax Act and also, he can claim other expenses e.g. repairs, insurance, municipal taxes, interest on borrowed capital etc. for such business income.

(e) Taxability of rental income from a owned house property

Rents or income arising from ownership of any house property cannot be taxed under any other head since Section 22 provides a specific head for charge of such income to tax. In the case of Commercial Properties Ltd. v. C.I.T. 3 ITC 23, the assessee company had the sole object of acquiring lands, building houses and letting the premises to tenants. It was held that the income from property was taxable under Section 22 and not under Section 28, i.e., profits and gains of business or profession. However, where the subject which is let is not a mere tenement, but is a complex one, e.g., a well-equipped theatre, safe deposits vaults, or vaults for storing or preserving films, including special devices, facilities and services or a well-furnished paying guest establishment

- the income cannot be said to be derived from mere ownership of house property but may be assessable as income from business [C.I.T. v. National Storage (P) Ltd. (1967) 66 ITR 596 (SC)].

Similarly, the following income from buildings is not assessable under this head:

(a) **Buildings or staff quarters let out to employees and others:** Where the assessee lets out the building or staff quarters to the employees of business whose residence there is necessary for the efficient conduct of business, the rent collected from such employees is assessable as income from business and taxable under the head business or profession and not under this head. [CIT v. Delhi Cloth & General Mills Co. Ltd. (1966) 59 ITR p.152 (Punjab)].

(b) **If building is let out to authorities for locating bank, post office, police station, central excise office, etc.:** income will be assessable as income from business provided the dominant purpose of letting out the building is to enable the assessee to carry on his business more efficiently and smoothly. [CIT v. National Newsprint and Paper Mills Ltd. (1978) 114 ITR 388 (MP)].

(c) **Composite letting of building with other assets:** Where the assessee lets on hire machinery, plant or furniture belonging to him and also buildings and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting is chargeable to tax under the head “Income from other Sources” if it is not chargeable to income-tax under the head “Profits and gains of business or profession” [Section56(2)(iii)].

However, if rent is separable between rent of building and rent for other facilities viz. rent of machinery, plant or furniture or other facilities etc,

then rent of building would be taxable as Income from house property and rent for machinery, plant or furniture or other facilities would be taxable as either Income from Other Sources or Profits and gains of business or profession, depending upon the facts of each case.

(d) **Income of State Industrial Development Corporation for letting out of sheds, etc.** is business income and is not taxable under Section 22 – CIT v. A.P. Small Scale Industrial Development 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.).

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 wil be allowed only in the year in which it was paid.

Rules made in this behalf - Notification No. 198/2001 dated 2-7-2001

The amount of rent which the owner cannot realise shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrevocable only if following conditions are satisfied:

(a) tenancy is bonafide;

(b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;

(c) the defaulting tenant is not in occupation of any other property of the assessee;

(d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfied the Assessing Officer that legal proceedings would be useless.

COMPUTATION OF ANNUAL VALUE/NET ANNUAL VALUE

Net annual value shall be computed in the following manner:
1. Determine the Gross Annual Value
2. Deduct municipal tax actually paid by the owner during the previous year from the Gross Annual Value.

For the purpose of computation of net annual value, properties can be classified into three categories :
(A) Properties let out throughout the year.
(B) Properties occupied by the owner for residential purposes or properties not self-occupied owing to employment at any other place.
(C) Partly let out and partly self occupied property.

A. Properties let-out [Section 23(1)]

Gross annual value shall be higher of
(a) Expected Rent
(b) Actual rent received or receivable.

The higher of Municipal value and fair rental value shall be **Expected rent**. Therefore, from these Judgments, it is evident that expected rent shall not exceed the Standard rent.

GROSS ANNUAL VALUE HIGHER OF THE FOLLOWING ACTUAL RENT RECEIVED FAIR RENT MUNCIPAL VALUE HIGHER OF THE FOLLOWING EXPECTED RENT (cannot exceed standard rent)

Municipal Value: Municipal value is the value determined by the municipal authorities for levying municipal
taxes on house property.

Fair rent: Fair rent is the amount which a similar property can fetch in the same or similar locality, if it is let for a year.

Standard Rent: The standard rent is fixed under Rent Control Act. In such a case, the property can not be let for a amount which is higher than the standard rent fixed under the Rent Control Act.

Actual rent received or receivable: Actual rent is rent for let out period. It is the de facto rent (i.e. what should have been the actual rent). For example, if water and electricity bills of tenant are payable by the owner, then de facto rent will be calculated by reducing from the rent received/receivable the amount spent by the owner for those bills. On the other hand, for example, if any obligation of water and electricity bills is met by the tenant, then amount spent by the tenant will be included for the purpose of calculating actual rent received/receivable or
de-facto rent. Municipal taxes are to be borne by the occupier who in the case of let out property is the tenant. Therefore, if such municipal taxes are borne by the tenant, the rent received/receivable should not be increased to calculate the de-facto rent.

While computing the net annual value the following deduction are made from the gross annual value :

Municipal Taxes : The taxes including service taxes (fire tax, conservancy tax, education, water tax, etc.) levied by any municipality or local authority in respect of any house property to the extent to which such taxes are borne and paid by the owner, and include enhanced municipal tax finally determined on appeal and payable by assessee - Clive Buildings Cola Ltd. v. CIT (1989) 44 Taxman 160.

However, deduction in respect of municipal taxes will be allowed in determining the annual value of the property only in the year in which municipal taxes are actually paid by the owner.

Where the tax on property is 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.)].

Even where the property is situated outside the country taxes levied by local authority is that country are deductible is deciding the annual value of the property. [CIT v. R Venugopala Riddiar (1965) 58 ITR 439 (Mad.)] While calculating the annual value in accordance with Section 23(1) the following situations may arise:

(i) If the property is let out throughout the previous year (No unrealised rent and no vacancy).

(ii) If the property is let out throughout the previous year, but the entire rent could not be collected.

(iii) If the entire rent is collected but the property remains vacant.

(iv) If the property remains vacant and the entire rent is not collected.

DEDUCTIONS FROM INCOME UNDER THE HEAD HOUSE PROPERTY (SECTION 24)

W.e.f. Assessment Year 2002-03, income chargeable under the head "Income from house property" shall be computed after making the following deductions, namely:

(a) Standard deduction

A sum equal to 30% of the annual value;

(b) Interest on borrowed capital

Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital:

Provided that in respect of property referred to in sub-section (2) of section 23, the amount of deduction shall not exceed ` 30,000:

Provided further that where the property referred to in the first proviso to acquired or constructed with capital borrowed on or after the 1st day of April, 1999 and such acquisition or construction is completed within three years from the end of the financial year in which capital was borrowed, the amount of deduction under this clause shall not exceed ` 1,50,000.

Amounts not deductible from income from house property (Section 25)

Where the amount of interest on money borrowed for the purpose of house property is payable outside India and it is chargeable under the Act, it shall not be allowed as a deduction unless:

(i) tax has been paid or deducted at source in respect of such payment, or

(ii) there is a person in India who may be treated as an agent or representative of the non-resident to whom
such payments have been made.

DEDUCTION IN RESPECT OF INTEREST ON HOUSING LOAN UNDER SECTION 80EE

Notes

Keeping in view the need for affordable housing, an additional benefit for first-home buyers is provided by inserting a new section 80EE in the Income-tax Act relating to deduction in respect of interest on loan taken for residential house property.

The new section 80EE seeks to provide that in computing the total income of an assessee, being an individual, there shall be deducted, in accordance with and subject to the provisions of this section, interest payable on loan taken by him from any financial institution for the purpose of acquisition of a residential house property. The amount of deduction shall not exceed one lakh rupees and shall be allowed in computing the total income of the individual for the assessment year beginning on 1st April, 2014 and in a case where the interest payable for the previous year relevant to the said assessment year is less than one lakh rupees, the balance amount shall be allowed in the assessment year beginning on 1st April, 2015.

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.

EXEMPTIONS

(A) Items of income from house property which are exempt from Income-tax are:

(i) Income from house property situated in the immediate vicinity of or on the agricultural land and used as a dwelling house, store-house or other out-house by the cultivator or receiver or rent-in-kind. [Section 2(1A) read with Section 10(1)].

(ii) Income from property held under trust for charitable or religious purposes (Section 11).

(iii) Income from property occupied by the owner for the purposes of his business or profession carried on by him and the profits of which are chargeable to Income tax. If the profits of business or profession are not chargeable to tax because the income of that business or profession is

exempt from tax, the income from the house property shall be chargeable under this head (Section 22).

(iv) Income from residential house where the house consists of one residential house only and it could not be occupied by the owner on account of his employment, business or profession carried on at any other place and he lives at such place in a house which does not belong to him. The income shall be exempt provided:

(a) The house was not occupied by the owner during the whole of the previous year; or

(b) The house was not let; or

(c) No other benefit was derived by the owner [Section 23(3)].

(v) Income from house property belonging to a Registered Trade Union [Section 10(24)].

(vi) Income of an authority constituted under any law for the time being in force for the marketing of commodities; any income derived from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities [Section 10(29)].

(vii) The annual value of any one palace in the occupation of an ex-ruler [Section 10(19A)].

(viii) Income from house property belonging to a local authority [Section 10(20)].

(ix) Income from property of an authority constituted for the purpose of planning, development, or improvement of cities, towns and villages [Section 10(20A)].

(x) Income from property of the approved scientific research association subject to fulfillment of certain conditions [Section 10(21)].

(xi) Income from property of a games association [Section 10(23)].

(xii) Income from property in the case of a person resident of Ladakh. [Section 10(26A)].

(xiii) Income from property of a political party (Section 13A).

(B) Income which are included in gross total income but do not form part of the total income:

(i) Income of a co-operative society from the letting of go downs 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)].

Income From Business or Profession

‘BUSINESS’ OR ‘PROFESSION’

The most important head of income is the head ‘Profits and gains of Business or Profession’. While the provisions of Sections 28 to 44D deal with the method of computing income under head “Profits and Gains of Business or Profession”.

Meaning of Business

– The meaning of the expression ‘Business, has been defined in Section 2(13) of the Income-tax Act. According to this definition, business

includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. The concept of business presupposes the carrying on of any activity for profit, the definition of business given in the Act does not make it essential for any taxpayer to carry on his activities constituting business for a considerable length of time.

– In other words, for even a single or isolated transaction entered into with the idea of making profit would be a business within the meaning of the definition given in Section 2(13). The concept of business presupposes the existence of the assessee's intention to make a profit out of his transactions.

– The object to make profit must be inherent in the transaction although the ultimate result of the transaction may be such that the assessee had to incur loss. Thus, the assessability of profits and gains from business under this head does not in any way depend upon the ultimate outcome of the venture or transaction yielding income or loss.

Meaning of Profession

– The expression 'Profession' has been defined in Section 2(36) of the Act to include any vocation. In the case of a profession, the definition given in the Act is very much inadequate since it does not clearly specify what activities constitute profession and what activities do not.– According to the generally accepted principles, the meaning of the term 'profession' involves the concept
of an occupation requiring either intellectual skill or manual skill controlled and directed by the intellectual skill of the operator.

– For instance, an auditor carrying on his practice, the lawyer or a doctor, a painter, an actor, an architect or sculptor, would be persons carrying on a profession and not a business.

– The common feature in the case of both profession as well as business is that the object of carrying them out is to derive income or to make profit. The process of making the profit would be the main area of difference between the two while the ultimate object is common to both.

Continuity of Business or Profession

As has already been mentioned, the existence of continuity in the business or profession is not an essential condition for making the assessee liable to tax under this head. Thus, receipts arising from the exercise of a business or profession would still be chargeable to tax under this head although they may be both casual and non-recurring in nature. Consequently, the exemption available under Section 10(3) for receipt of a casual and non-recurring nature would not be available to income derived from business although carrying on the business would be casual and the receipt of income may be such that it does not recur at all. In determining the taxability of profit under the head business or profession arising from transactions of an isolated nature, the following principle should be taken into account to ascertain whether the transaction is an adventure in the nature of trade:

(i) The transaction is said to be in the nature of trade only if some of the elements of trade are found in the transaction, the most important being the object of making profit. It is not essential that all the activities following the main object of the business and which constitute separate

transactions by themselves must be entered into with the idea of making profit. In other words, a person whose object is to carry on a business may indulge in certain transactions knowing fully well that he would have to incur loss although he may derive income from the others (e.g. the case of dealer in shares).

(ii) The purchase of an asset or property with the intention to resell the same may be one of the vital factors in determining the nature of the transaction but the intention to resell at a profit is not to be taken as the only factor for this purpose. This is because of the fact that the cases where the assessee has no intention of enjoying or holding the property, there would be a strong presumption that the transaction is in the nature of trade although this presumption may be rebuttable in certain circumstances depending upon the facts of the case.

(iii) It is, however, not possible to evolve a common test or formula which could be applied uniformly in all cases to determine whether a particular transaction is an adventure in the nature of trade or not. The nature of the transaction will have to be determined in each case depending upon the facts or circumstances. The concept of income based upon the principles discussed under Section 4 laying down the principles to be applied for distinguishing between receipts of a capital and revenue nature must be followed even in cases where income is to be computed under this head. In other words, the taxability of income under this head depends primarily upon the fact that the receipt in question is of a revenue nature and is consequently assessable as income under the Act. However, there are a few cases where capital receipts are also chargeable to tax as income from business as has been explained in the next pages.

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.)].

POINTS FOR CONSIDERATION WHILE COMPUTING INCOME UNDER THE HEAD BUSINESS OR PROFESSION

The provisions of the Income-tax Act contained in Sections 28 to 44DB regulate the method of computing income from business.

The income from business to which a person is chargeable under this head represents not the gross receipts from the business but the profits and gains derived from there. For instance, in the case of a businessman, the gross sale proceeds would not be the basis for levying tax but it is net profit or the profit or gain as determined in accordance with sections 28 to 44DB.

Method of Accounting (Section 145)

The profits and gains of a business are to be computed in accordance with the method of accounting regularly and consistently followed by the assessee or the method of accounting followed is such that income, profits or gains cannot properly be ascertained therefrom, the income-tax authorities are entitled to compute the income of the assessee on such basis and in such manner as they deem fit.

An assessee, for the purpose of his business, may follow the cash system of accounting or the mercantile system of accounting. Both these methods are well recognised for income-tax purposes and the tax authorities are bound by the method adopted by the assessee. The tax authorities are not also empowered to reject the method of accounting regularly followed by the assessee for the purpose of his business except, however, in cases where the method is not correct, complete or scientific.

An assessee may also follow the hybrid system of accounting for his business or profession. The hybrid system is the combination of the cash system and the mercantile system. This is mostly done in the case of professional men who follow cash system for their receipts and mercantile system for their payments.

Income earned in Cash or in Kind

The income that is chargeable to tax under this head may be realised by the assessee in cash or kind. In cases where the profit is realised in any other form than cash, the market value of the commodity received as income should be taken to be the quantum of income chargeable to tax.

Even in cases where an assessee is in receipt of money from his clients or other persons who are under no obligation to make such payment, the assessee would still be chargeable to tax if these monies were received by him in the ordinary course of business or profession. For instance, any amount paid to a Chartered Accountant by a person who has not been his client but who has been benefitted by his professional service to another, would be assessable as the Chartered Accountant's income from profession.

The person carrying on the business or profession would be chargeable to tax under this head regardless of the fact that the profits or gains made by him ultimately go to the benefit of some other person or to the business community or public body as a whole. In other words, the subsequent application of the money derived by way of income from business is immaterial for the purpose of assessment of the businessman.

Continuation of Business or Profession

The chargeability to tax under Section 28 is based primarily upon the condition that the assessee must have carried on a business or profession at any time during the accounting year, though not necessarily throughout the accounting year.

But there may be a few cases (e.g. deemed profits taxable under Section 41) where even if no business is carried on during the accounting year, the assessee would still be chargeable to tax.

Ownership of Business is not Necessary for Taxability

In order to be taxable in respect of the income of a business it is not essential that the business must be carried on by the same person who is the owner thereof. Even if the owner authorises some other person to carry on the business on his behalf or the owner is deprived by the court under certain circumstances of the right to carry on his own business, the owner will still be taxable under this head.

Similarly, it is not only the legal ownership but also the beneficial ownership that has to be considered. In this connection it has to be kept in view, as to who is the actual recipient of the income which is going to be taxed. For example, where a business is acquired for the benefit of a company which is going to be incorporated and the promoters carry on the business and earn profits during the period prior to the incorporation, if the company accepts the action of the promoters and receives from them the past profits made prior to its incorporation, the company shall be assessable under this section in respect of such profits although before the incorporation of the company the promoters were the legal owners of this business yet as the company was the beneficial owner (as it has actually received the profits) of the business, it will be assessable on these profits. [CIT v. 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].

Business may be Legal or Illegal

While profit motive is indicative of and is not the sole test for determination of the fact that the adventure of an assessee is in the nature

of trade and consequently constitutes a business, it is immaterial whether the business is legal or illegal.

In other words, the taxability of the income from business does not in any way depend upon or is affected by the taint of illegality in the income or the sources. Income derived from illegal activities is as much chargeable to tax as income from other operations. The fact that the person who carried on the illegal activities is punishable under the appropriate law, does not exclude him from the liability to income-tax. However, the loss arising directly in the course of an illegal business is deductible as business expenditure in computing the profits from that business. [C.I.T. v. S.C. Kothari (1971) 82 I.T.R. p. 794 (S.C.) and C.I.T. v. Piara Singh (1980) 124 I.T.R. p. 40 (S.C.)].

Profit Motive is not the Sole Consideration for Taxability

There may be assessees who carry on business without the primary object of making profits (e.g., a co-operative society which tries to cater to the needs of its members without the object of making maximum profits). Even in such cases, if profits arise from the business carried on by the assessee and such profits are incidental to the business, the assessee would still be taxable. Therefore, profit motive is not the only test of determining the taxability of income from any activity constituting business or profession.

Computation of Income Separately for each Business

A taxpayer is entitled to carry on as much number of businesses as he can, both in his own name and in the name of others. The profits and gains of all businesses or professions would be assessable under this head. But the profit of each business must be computed separately from one another and the deductions and allowance permissible to each business must be allowed against the income derived therefrom. The income chargeable under this head is the aggregate of the net result of the various business or businesses or profession(s) carried on uring the accounting year. Thus, the loss arising from one business would be set off against income from another business falling under the same head and the net result after such set off would alone be assessable
income under this head. The law does not permit an assessee to club all the sources of his income under the
head and claim a composite amount towards expenses and losses attributable to all the businesses. If an
assessee has incurred an item of expenditure for the purpose of many businesses the expenditure in question
will have to be apportioned against each business for the purpose of allowance.

PROFITS AND LOSSES OF SPECULATION BUSINESS

The term speculation has not been exhaustively defined in the income-tax Act, but it normally denotes the
meaning commonly assigned to it in commercial practice. However, Section 43(5) defines the expression
"speculative transaction" as "a transaction in which a contract for the purchase or sale of any commodity including
stocks and shares is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips". Where a

company (other than banking or financial company) deals in shares of other companies, the income from such business is treated as income from speculative business.

Transactions not considered as speculative transactions

However, the following four forms of transactions have been specifically excluded from the scope of peculative
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 respectof 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 edging
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.

Computation of Profits of Business or Profession

The profits and gains of business or profession are computed in accordance with the provisions contained in Sections 30 to 43D. Sections 30 to 37 contain those deductions which are expressly allowed while computing profits of business or profession. Section 40 provides those expenses which are allowed on the basis of general commercial principles while computing profits of business or profession. It is necessary to know those principles before studying the deductions expressly allowed while computing profits of business or profession.

The general commercial principles are as under:

(1) Profits should be computed according to the method of accounting regularly employed by the assessee, provided that actual profit can be ascertained by this method, whether on receipt basis or accrual basis.

(2) Only those expenses and losses are allowed as deductions which were incurred or sustained during the relevant previous year and related to business.

(3) These losses and expenses should be incidental to the operation of the business. For example, embezzlement by an employee during the course of business is a loss incidental to the business. Similarly, loss from dacoity in a bank is also a loss incidental to the business of a bank. (4) If a business has been discontinued before the commencement of the

previous year, its expenses cannot be allowed as deduction against the income of any other running business of the assessee.

(5) There are some essential expenses, though neither expressly allowed nor disallowed, but are deductible while computing the profits of business or profession on the basis of general commercial principles provided that these are not expenses or losses of a capital nature or personal nature.

(6) Any expenditure incurred in consideration of commercial expediency is allowed as deduction.

(7) Deduction can be made from the income of that business only for which the expenses were incurred. The expenses of one business cannot be charged against the income of any other business.

Computation of Income under the head "Profits and Gains from Business or Profession"

Profit as per P&L A/c ....

Add:

(i) Expenses or losses disallowed but charged in P&L A/c

(ii) Incomes taxable as business income but not credited to the P&L A/c

(iii) Expenses in excess of the allowed amount charged in P&L A/c

(iv) Undervaluation of closing stock or overvaluation of opening stock.

Deduct:

(i) Expenses or losses allowed but not debited to P&L A/c

(ii) Incomes not taxable as business income but credited to the P&L A/c

(iii) Incomes exempt from tax but credited in P&L A/c

(iv) Overvaluation of closing stock and undervaluation of opening stock.

Taxable Income from Business or Profession ....

DEDUCTIONS ALLOWABLE

(A) Rent, Rates, Taxes, Repairs and Insurance for Buildings (Section 30)

In respect of the business premises used by the assessee, the deduction is available in computing the income from business for the following items:

(a) Where the premises are occupied by the assessee in his capacity as tenant, the rent paid for such premises would be deductible. In cases where the assessee has also undertaken to bear the cost of repairs as part of the terms of his tenancy agreement, the amount of expenses actually incurred by him on account of repairs would also be deductible.

(b) If the assessee occupies premises not in the capacity of a tenant but as its owner, a lessee or licensee, the expenses incurred on current repairs to the premises would be deductible.

(c) The assessee is also entitled to deduct any amount paid by him on account of land revenue, local rates or municipal taxes in respect of the premises.

(d) Any premium paid in respect of insurance against risk of damage or destruction of the premises, is also deductible.

(B) Repairs and Insurance of Machinery, Plant and Furniture (Section 31)

– Income from business or profession should be computed after allowing deductions under Section 31 in respect of repairs and insurance of the machinery, plant or furniture used for the purpose of business or profession. The deduction allowable would cover the amount of

expenses on account of current repairs and also the amount of any premium paid in respect of insurance of the machinery, plant or furniture against any risk of damage or destruction thereof.

– The assessee is entitled for deduction in respect of repairs and insurance of these assets only if these assets have been actually used for the purpose of the business of the assessee during the accounting year the profits of which are subjected to tax. Thus, if the assets are used in some business, income of which is not chargeable to tax, the assessee cannot claim deduction in respect of these expenses against the income from some other business, the profits of which are taxable.

– It is not essential that the assessee must be the owner of these assets in order to claim deduction in respect of these expenses. Even if these assets have been taken on hire, the assessee would still be entitled for the deduction.

– On the other hand, if the assessee is the owner of the machinery, plant or furniture and these assets are held as the assets of the business but have not been made use of for the purposes of the business during the accounting year, no deduction would be available. But the allowance of these expenses does not in any way get affected by the fact that these assets are used only for a part of the accounting year in the business of the assessee.

– The allowance for repairs covers not only the expenses of ordinary maintenance and replacement of the small parts but also of the renewal or renovation of the asset.

– However, the expenses incurred towards replacement or reconditioning of the machinery or plant or furniture, would not be allowable under this section because the cost of replacement or reconditioning of an asset would be an expenditure of a capital nature since it results in the acquisition of a capital asset or benefit of an enduring nature.

In cases where the assessee incurs expenses in respect of repairs of the plant and machinery of a large sum in one year and these repairs relate to a number of years which have not been actually carried out, the deduction allowable under this section would be only in respect of the expenses on current repairs although the expenses in regard to arrears of repairs may be deductible under Section 37(1).

– The simple test that must be constantly borne in mind is that as a result of the expenditure which is claimed as an expenditure for repairs, what is really being done is to preserve and maintain an already existing asset. The object of the expenditure is neither to bring a new asset in to existence, nor to obtain any fresh advantage. [New Shorrock Spinning and Manufacturing Co. Ltd. v. C.I.T. (1956) 30 I.T.R. p. 338]. The replacement of the old diesel engine by a new engine in a motor van used for business purposes was done with a view to preserve and maintain the asset in existence and, as no enduring benefit was derived by the assessee, the expenditure was allowed. [Nathmal Bankat Lal Parikh and Company v. C.I.T. (1980) 122 I.T.R. p. 168].

(C) Depreciation (Section 32)

In computing income from business, one of the most important items of allowances is the allowance for depreciation provided by Section 32 of the Income-tax Act. The deduction towards depreciation is very essential

to arrive at the income of the assessee and also to amortise the capital cost of the amount invested in buildings, machinery, plant and furniture. The purpose of allowing depreciation is to provide in course of time for the replacement of asset with the help of the capital cost of the asset which is allowed to be amortised over a period of time. The provisions for allowing depreciation are contained in Section 32 and are regulated under Rule 5 of the Income tax Rules. The rates of depreciation are also provided in the Income-tax Rules.

Conditions for allowability of Depreciation

In order that the depreciation is allowable, the following conditions must be fulfilled:

(a) Classification of Assets:

The assets in respect of which depreciation is claimed must be buildings, machinery, plant or furniture. In addition to these tangible assets intangible assets like know how, patent rights, copy rights, trade marks, licences, franchises or any other business or commercial right of similar nature acquired on or after 1.4.1998 are eligible for depreciation. These intangible assets will form a separate block of assets. As and when any capital expenditure is incurred by an assessee on acquiring such intangible assets, the amount of such expenditure will be added to the block of intangible assets and depreciation will be claimed on the written down value at the end of financial year. While taking into account the depreciation allowance in respect of a building, only the cost of the building is to be taken into account but not the cost of the land on which the building is erected because the land does not suffer any depreciation as a result of wear and tear or its usage. Thus, the term building used in this context refers only to the super- structure and not the land on which it is erected [C.I.T. v. Alps Theatre (1967) 65 I.T.R. p. 377 (S.C.)]. Roads within a factory compound form part of building which is used for the purpose of the business and as such are entitled to depreciation. Similarly, residential quarters provided to the employees are used for the business in the sense that they are used for and such user is incidental to the carrying on the business. Therefore, the roads to such residential quarters are also entitled to depreciation at the rates applicable to first class building [C.I.T. v. Kalyani Spinning Mills Ltd. (1981) 128 I.T.R. p. 279 (Cal.)]. However, the M.P. High Court has held that expenditure incurred on construction of metal roads for approach to trenches to dump the waste and night soil, is capital expenditure. Moreover, such roads are not plant and machinery. Hence, the assessee is not entitled to depreciation on the cost of the metal roads [Indore Municipal Corporation v. C.I.T. (1981) 132 I.T.R. p. 540 (MP)].

Plant

The term ‘plant’ for the purpose of allowance of depreciation has been defined in Section 43(3) to include ships, vehicles, books, scientific apparatus and surgical equipments used for the purposes of the business or profession. However, on the basis of cases decided by the courts, the following are also included in the term ‘plant’:

(i) In the case of a hotel, pipe and sanitary fittings [C.I.T. v. Taj Mahal Hotel (1971) 82 I.T.R. p. 44 (S.C.)].

(ii) In the case of electric supply company, mains service lines and switch gears [C.I.T. v. Warner Hindustan Limited].
(iii) Well.
(iv) In the case of manufacturer of oxygen, gas-cylinder for storing gas.
(v) Technical know-how in the form of blue prints, instruction, technical manuals. [C.I.T. v. Festo Elgi Pvt. Ltd. (1981) 129 I.T.R. p. 499].
(vi) Thermocole insulation. [C.I.T. v. Yamuna Cold Storage (1981) 129 I.T.R. p. 728 (P.&.H.)].
(vii) New Coils. [Panipat Co-operative Sugar Mills Ltd. v. C.I.T. (1981) 129 I.T.R. p. 73 (P.&.H.)].
(viii) Data Processing Machines. [C.I.T. v. I.B.M. World Trade Corporation (1981) 130 I.T.R. p. 739 (Bom.)].
Since the definition of plant is inclusive in nature, it should be taken to cover all goods and chattels, whether fixed or moveable which a businessman may keep for the purpose of employment in his business with some degree of certainty and duration of time.
However, following are some of the instances which are not held as plant:
1. Warehouses for storage purposes
2. Horses
3. Human body
4. Bed of River
5. Water storage tanks used for storing water by the supplier for irrigation purposes.
6. Cinema Theaters
7. Hotel Building
Moreover, 'tea bushes', 'livestock', buildings or furniture and fittings have been excluded from the definition of plant w.e.f. assessment year 1962-63.
(b) Ownership Vs. lease:
Depreciation is allowable to the assessee only in respect of those capital assets which are owned by him. In case of a building, the assessee must be owner of the super-structure and not necessarily of the land on which it is constructed. If the assessee is only a tenant of the building but not its owner he is not entitled for allowance in respect of depreciation thereof. Where the land on which the building is constructed has been taken on lease by the assessee, the allowance of depreciation would be admissible only if, according to the lease deed, the assessee is entitled to be the owner of the super-structure. The fact that as part of the terms of the lease deed, the building, after expiry of the lease is to be transferred to the lessor of the land would not affect the allowance for depreciation.
In the case of assets acquired on hire-purchase e.g., plant and machinery taken on hire, the assessee would not be the owner thereof and consequently would not be entitled for depreciation in respect of the same. But if the plant and machinery had been acquired on instalment basis, the assessee becomes the owner of the assets the moment the purchase or sale is concluded and consequently is entitled to depreciation although a part or whole of the price is payable in future.
(c) Used for the purpose of Business or Profession:

The allowance for depreciation is subject to the condition that the assets on which depreciation is claimed are actually used by the assessee for the purposes of his business or profession during the accounting year. The allowance for depreciation, however, is not subject to the condition that the asset in question must be used throughout the relevant accounting year in order to enable the assessee to claim depreciation. Thus, even if the asset is used for a very small fraction of the accounting year, the assessee would be entitled to depreciation in respect of the full amount allowable as if the asset had been used throughout the accounting year. Even in the case of seasonal factories (e.g., sugar manufacturing companies), the full amount of depreciation is allowable if the asset had been used at any time during the accounting year in the factory. In cases where the depreciable asset is used partly for business purposes and partly for other purposes, the deduction towards depreciation allowable under Section 32 would be of a sum proportionate to the depreciation allowance to which the assessee would have otherwise been entitled, in the year in which the depreciable asset is sold, destroyed, discarded or demolished, no depreciation at the rates
prescribed in the Income-tax Rules would be allowable.

(d) Amount of deduction shall not exceed actual cost: The total amount of all items of depreciation allowance allowed to the assessee from year to year shall not exceed the actual cost of the block of assets to the assessee. **(e) No deduction on sold assets:** No depreciation is allowable in respect of the depreciable asset if the asset concerned is sold, destroyed, discarded or demolished in the same year in which it was acquired.

(f) In order to be entitled to allowance towards depreciation, the assessee must furnish the prescribed particulars contained in Annexure 'B' attached to the Form of the Return of Income-tax. Any failure on the part of the assessee to furnish fully and truly all material facts, including the particulars prescribed for this purpose, would entitle the income-tax authorities to refuse to allow deduction towards depreciation.

(g) The Finance Act, 1995 has deleted w.e.f. assessment year 1996-97 the provision pursuant to which one could write off the entire cost of plant and machinery in the very first previous year in which it was put to use provided its actual cost did not exceed ` 5,000, to prevent the widespread misuse of the concession.

(h) The Finance (No. 2) Act, 1996 has rationalised the depreciation provisions, inter alia as follows:

In case of joint ownership of an asset, depreciation would be allowed to each of the owner in proportion to the contribution to the total cost of the asset; and In case of amalgamation during the course of a previous year, the amalgamating company and the amalgamated company shall share the depreciation in proportion to the number of days during which the assets remained under their respective ownership.

Similarly, in case of demerger during the course of a previous year (w.e.f. 1.4.2000), the demerged company and the resulting company shall share the depreciation in proportion to the number of days during which the assets remained under their respective ownership.

Meaning of Block of Assets

The depreciation is provided in respect of "Block of assets". As per Section 2(11) Block of assets means "a group of assets falling within a class of assets, being tangible assets such as buildings, machinery, plant or furniture and intangible assets, being know-how, patents, copyrights, trademarks, licences, Franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed".

Moreover depreciation is now allowed on the written down value of all types of assets. Again, no deduction shall be allowed under this clause in respect of any motor car manufactured outside India, where such motor car is acquired by the assessee after the 28th day of February, 1975, and is used otherwise than in a business of running it on hire for tourists or,

(a) outside India in his business or profession in another country, and

(b) in respect of any machinery or plant if the actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under Section 42 of the Act.

Important Terms

For the purposes of depreciation, the following terms are important:

(i) Actual Cost

(ii) Written Down Value

(iii) Classification of Depreciation

(i) Actual Cost [Section 43(1)]

For computing depreciation, actual cost is the basis in the case of all assets for the first year when the assets are put to use for the purpose of the business. Subsequently, even in the case of depreciable asset when the written down value is to be ascertained for the purpose of allowing depreciation, the written down value should be taken to be the book value of the asset after allowing deduction in respect of the depreciation allowable under the Income-tax Act from the actual cost of the asset concerned. The actual cost of an asset is essential for the purposes of allowing depreciation also because of the fact that the aggregate of all the items of depreciation allowable to an assessee in respect of any depreciable asset shall not exceed the amount of its actual cost.

The actual cost of an asset to the assessee is normally the amount of capital expe nditure 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

(b) Assets acquired by way of gift or inheritance

(c) Assets transferred to reduce tax liability

(d) Assets earlier transferred re-acquired by the Assessee

(e) Building brought into use for business purpose subsequent to its acquisition

(f) Asset transferred by holding company to 100% subsidiary company or vice-versa

(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

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

(j) Actual Cost of Cenvetable Asset

(k) Asset acquired where portion of cost met by some other person

(l) Asset acquired by non-resident outside India but for business or profession in India
(m) Asset acquired under scheme of corporatisation of Recognised Stock Exchange
(n) Capital Asset on which deduction has been allowed or allowable u/s 35AD
(ii) Written down value [Section 43(6)]
(iii) Classification of depreciation
(a) Normal Depreciation [Section 32(1) Rule 5]
(b) Depreciation on Straight line basis
Terminal depreciation
(c) Additional Depreciation [Section 32(1)(iia)]
(iv) Calculation of Written Down Value of a block of asset [Section 43(6)]
Incentive for acquisition and installation of new plant or machinery by manufacturing company
(Section 32AC)
If a company, –
(a) is engaged in the business of manufacture and production of an article or thing; and
(b) invests a sum of more than ` 100 crore in new assets (plant or machinery) during the period 1st April, 2013 to 31st March, 2015, then,
(i) for assessment year 2014-15, a deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the cost of such assets exceeds Rs.100 crore shall be allowed;
(ii) for assessment year 2015-16, a deduction of 15% of the WDV as on 1st April 2015 shall be allowed. The phrase "new asset" has been defined as new plant or machinery but does not include –
(i) any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;
(ii) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
(iii) any office appliances including computers or computer software;
(iv) any vehicle;
(v) ship or aircraft; or
(vi) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.
Transfer of the plant or machinery for a period of 5 years has also been restricted. However, this restriction shall not apply in a case of amalgamation or demerger but shall continue to apply to the amalgamated company or resulting company, as the case may be.

(D) Tea/Coffee/Rubber Development Account (Section 33AB)

With effect from the assessment year 1991-92, the substituted Section 33AB is applicable to an assessee carrying on the business of growing

and manufacturing tea in India. For claiming the deduction u/s 33AB the assessee has to satisfy the following conditions:

(1) Deposit of amount:

Where an assessee, carrying on business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of his income, whichever is earlier:

(a) Deposited with the National Bank any amount or amounts in an account (hereinafter in this section referred to as the special account) maintained by the assessee with the Bank in accordance with and for the purposes specified in a scheme (hereafter in this section referred to as the scheme) approved in this behalf by the Tea Board of India or the Coffee Board of India or the Rubber Board; or

(b) Amount of Deduction:

Deposited any amount in an account (hereafter in this section referred to as the Deposit Account) opened by the assessee in accordance with, and for the purposes specified in, a scheme framed by the Tea Board or the Coffee Board or the Rubber Board, as the case may be (hereafter in this section referred to as the deposit scheme) with the previous approval of the Central Government, the assessee, shall be allowed a deduction (before the loss, if any, brought forward from earlier years is set off under Section 72), of – (a) a sum equal to the amount or the aggregate of the amounts so deposited; or (b) Forty per cent of the profits of such business (computed under the head “Profits and gains of business or profession” before making any deduction under Section 33AB), whichever is less. However, where such assessee is a firm, any association of persons or body of individuals, deduction under this section shall not be allowed in the computation of the income of any partner, or member etc., of the firm/ AOP/BOI.

Also, where any deduction, in respect of any amount deposited in the special account has been allowed in any previous year, no deduction shall be allowed in respect of any other previous year.

(2) Audit:

The deduction is admissible to only those assessees whose accounts have been audited and the assessee furnishes along with his return of income the report of such audit in the prescribed form and duly signed and verified by such accountant. In cases where the accounts of the tax payer are required to be audited under any other law, it would be sufficient if the accounts are audited under that law and the audit report as per that law is furnished with the return along with a further report in the form prescribed for the purposes of this provision.

(3) Withdrawal of Amount:

(a) There is a restriction on the withdrawal of the amount standing in the credit of such Special account of the assessee, i.e., the withdrawal must be made either: (i) for the purposes specified in the scheme, or, in the following circumstances: (a) closure of business; (b) death of an assessee; (c) partition of a H.U.F.; (d) dissolution of a firm; (e) liquidation of a company.

(b) Notwithstanding anything contained in (a) above, where any amount standing to the credit of the assessee in the special account or in the

Deposit Account is released during any previous year by the National Bank or withdrawn by the assessee from the Deposit Account and such amount is utilised for the purchase of: (a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest-house;
(b) any office appliances (not being computers);
(c) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year;
(d) any new machinery or plant to be installed in an industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule, the whole of such amount so utilized shall be deemed to be the profits and gains of business of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(4) Consequences in case of closure of Business:

In the event of withdrawal of any amount in the event of: (a) closure of business or; (b) dissolution of a firm, the whole of such amount shall be deemed to be the profits and gains of business or profession of that previous year and chargeable to income-tax as if the business had not closed, or, the firm not dissolved and taxable in that previous year.

(5) Conversely, where any amount standing to the credit of the assessee in the special account or in the Tea Deposit Account is utilised by the assessee for the purposes of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed as a revenue deduction in computing the income chargeable under the head "Profits and gains of business or profession".

(6) Non-utilisation of any amount released by the National Bank, for being utilised by the assessee for the purposes of a business, in accordance with the scheme, renders the whole or part of the amount not utilised, as the case may be, deemed as profits and gains of business and, accordingly, chargeable to income-tax as income of that previous year. The exceptions to this provision are, when the amount is not utilised in the cases of: (i) death of an assessee; (ii) partition of a Hindu undivided family; (iii) liquidation of a company.

(7) Acqisition 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.

(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.

(F) Reserves for Shipping Business (Section 33AC)

No deduction under this section shall be allowed under this section for any assessment year commencing on or after 1st day of April, 2005 i.e from assessment year 2005-06.

(G) Expenditure on Scientific Research (Section 35)

The term "scientific research" means any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries. With a view to accelerating scientific research, Section 35 of the Act provides tax incentives.

(1) Revenue expenditure incurred by an assessee

(i) Assessee himself carries on scientific research [Section 35(1)(i)]

Where the assessee himself carries on scientific research and incurs revenue expenditure, deduction is allowed for such expenditure only if the research relates to his business.

Pre-commencement period expenses:

Further, revenue expenditure incurred by an assessee on payment of salary to research personnel and on material inputs during the period of 3 years immediately preceding the commencement of the business is regarded as having been laid out or expended in the previous year in which the business is commenced only salary is allowed if it is incurred for 3 years immediately preceding the previous year. Such expenditure incurred in the period before commencement of business is, therefore, allowed as deduction in computing assessee's income of the year in which the business is commenced. The deduction is available only in respect of expenditure incurred after March 31, 1973 on scientific research related to the assessee's business. In order to prevent misuse of the concession, deduction is limited to an amount certified by the prescribed authority. Prescribed authority as per rule 6 is Director General (Income-tax Exemptions) in concurrence with the Secretary, Department of Scientific and Industrial Research, Government of India. The 'salary' allowable for this purpose includes wages, annuity, pension or gratuity, fees or commission, profits in lieu of or in addition to any salary or wages, advance of salary and annual accretion to the balance at the credit of the employee participating in a recognised provident fund to

the extent to which it is chargeable to tax under rule 6 of Part A of the Fourth Schedule. It may be mentioned that expenditure incurred on the provision of "perquisites" before commencement of business is not allowed as deduction. In other words, expenditure incurred by the assessee on providing different perquisites (such as concessional residential accommodation, or any benefit or amenity provided free of cost or at a concessional rate etc.) to research personnel before commencement of business is not allowable as deduction.

(ii) Contribution made to outsiders [Section 35(1)(ii) & (iii)]

Where the assessee does not himself carry on scientific research but makes contributions to other institutions for this purposes deduction is allowed, if:

(a) the payment is made to an approved research association which has, as its object, undertaking of research related or unrelated to the business of assessee, a deduction of 175% of expenditure incurred is allowed.[Section 35(1)(ii)];

(b) the payment is made to an approved university, college or institution to be used for scientific research related or unrelated to the business of assessee [Section 35(1)(ii)], deduction shall be allowed to the extent of 175% of the actual expenditure.

(c) the payment is made to an approved company to be used by it for scientific research, deduction shall be allowed to the extent of 125% of the sum paid provided such company;

(i) is registered in India,

(ii) has as its main object the scientific research and development,

(iii) is, for the purposes of this clause, for the time being approved by the prescribed authority in the prescribed manner, and

(iv) fulfills such other conditions as may be prescribed.

a deduction of 125% of the sum paid shall be allowed as deduction. [Section 35(1)(iia)]

(d) the payment is made to a research association which has its object the undertaking of research in social science or statistical research or to a university, college or institution for the use of research in social sciences or statistical research, related or unrelated to the business of the assessee provided such university, college or institution is, for the time being, approved by the Central Government by notification in the Official Gazette [Section 35(1)(iii)], deduction shall be allowed to the extent of 125% of the sum paid.

The approval to research association, university, college or institution mentioned above is required to be obtained from the Central Government as provided by Finance Act, 1999 w.e.f. 1.4.2000.

The deduction available for such payments mentioned in clauses (a), (b) and (c) above to the extent of one and one-fourth times of any sum paid; with effect from Assessment Year 2000-01.

(2) Capital expenditure on scientific research

(i) Incurred by the assessee himself: Expenditure of a capital nature on scientific research related to the business carried on by the assessee is also allowable to the following extent:

(a) Where the capital expenditure is incurred after March 31, 1967, the whole of the capital expenditure incurred in any previous year is

deductible for that previous year. However, expenditure incurred on the acquisition of any land, whether acquired as such or part of any property, after 29.2.1984, is not deductible. (b) Capital expenditure incurred before the commencement of the business is deemed to have been incurred in the previous year in which the business is commenced, to the extent of the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business. Where an asset representing expenditure of a capital nature incurred before 1.4.1967, ceases to be used in a previous year for scientific research related to the business and the value of the asset at the time of the cessation, together with the aggregate of deductions already allowed falls short of the said expenditure then - (i) the deficiency is allowable as a deduction for the relevant previous year. Thereafter, no further deduction is allowable for any subsequent previous year.

Deduction by way of depreciation is not admissible in respect of an asset used in scientific research either in the year in which the capital expenditure is incurred or in a subsequent year. However, in the event of use of such assets for business, after cessation of use thereof for scientific research related to that business, the same asset shall become entitled to depreciation.

(ii) Carry forward and set off of deficiency in subsequent years:

If on account of inadequacy or absence of profits of the business, deduction on account of capital expenditure referred to in Section 35(1)(iv) of the Act cannot be allowed, fully or partly, the deficiency so arising is to be carried forward for 8 years and set off in any subsequent assessment year. However, carry forward of deficiency is subject to the condition that business loss already brought forward, if any, will have precedence over such deficiency in the matter of set off. To put it little differently, the aforesaid deficiency will be given the same treatment as is given to unabsorbed depreciation vis-a-vis brought forward business losses.

(iii) Consequences in case of amalgamation:

In pursuance of an agreement of amalgamation, if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provisions of Section 35 would apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the asset.

To avail the benefit of this section, the following procedures have also to be complied with:

– The research association, university, college or other institution makes an application in the prescribed form and manner to the Central Government for grant of approval or continuance of the scientific research.

– Before grant of the approval so sought, the Central Government may call for such documents including audited annual accounts or information from the research association, university, college, or other institution as it thinks necessary to satisfy itself about the genuineness of the activities of the research association, university, college or other

institution. The prescribed authority is also empowered to make such inquiries as it may deem necessary, in this behalf, and

– The notification issued by the Central Government shall have effect for such assessment year or years, upto a maximum of three assessment years, including the assessment year or years commencing before the date on which the notification is issued, as may be specified in the notification.

Any question as to what extent an activity constitutes scientific research or any asset was being used for scientific research, if arises it will be referred to the prescribed authority and its decision shall be final.

However, any such question relating to any activity of research association or university, college or other institution for which weighted deduction of one and one-fourth times the payment amount is given and for which approval from Central Government is required to be obtained, the question is also required to be referred to Central Government only and not to prescribed authority.

(3) Contribution to National Laboratory [section 35(2AA)]

Where any sum is paid to a National Laboratory, approved for this purpose by the Indian Council of Agricultural Research or the Indian Council of Medical Research or the Council of Scientific and Industrial Research etc., or to any University, or to Indian Institute of Technology, a weighted deduction of 200% of the sum paid shall be allowed as deduction under Section 35(2AA) of the Act.

(4) Expenditure on in-house research and development expenses [Section 35(2AB)]

Where a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in house research and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal to 200% of the expenditure so incurred upto 31.03.2017.

(H) Expenditure on Acquisition of Patent Rights or Copyrights (Section 35A)

Capital expenditure incurred by all assessees at any time after 28.2.1966 but before 1st April, 1998 for the purpose of acquisition of patent rights or copyrights for the purposes of his business, would be allowed to be amortised over a period of 14 years in equal instalments beginning with the previous year in which such expenditure is incurred or where such expenditure is incurred before the commencement of the business, the fourteen previous years would be calculated from the previous year in which the business commenced. With effect from 1.4.98 depreciation on intangible assets has been introduced. It is charged @25%. In view of this change expenditure under this section need not be amortised if incurred after the given date. However, where the rights became effective in a year priorto the one in which the expenditure is incurred, the deduction would be allowable to the assessee in respect of that period as remains unexpired. In other words, if at the time of acquisition (incurring the expenses) of the patent, say, the patent has already been utilized for

10 years by the assessee, the cost of the patent would be allowed as a deduction in four equal instalments in the remaining four years. In cases where the assessee acquires the patent or copyright at a time when only one year of its life remains, the entire cost of the patent to the assessee would be allowed in the year of acquisition itself. The other provisions relating to the allowance of deduction in respect of capital expenditure incurred for acquiring patents or copyrights are as under:

(i) Where a part of the right is sold and the proceeds of the sale are not less than the cost of acquisition thereof remaining unallowed, no deduction shall be allowed in respect of the previous year in which a part is so sold and in respect of any subsequent previous year.

(ii) Where the rights either come to an end or are sold in their entirety and the proceeds of sale are less than the cost of acquisition thereof remaining unallowed, a deduction equal to such cost remaining unallowed or as the case may be such cost remaining unallowed, as reduced by the proceeds of the sale, shall be allowed in the year in which rights come to an end or are sold.

(iii) Where the whole or any part of the rights is sold at a profit, the profits shall be chargeable as balancing charge. In case of the sale of the rights in the year in which the business is no longer in existence, the profits shall be chargeable as if the business is in existence in that previous year.

(iv) Where a part of the rights is sold and (iii) above does not apply the amount of deduction for that year and the subsequent year shall be calculated as follows:

(a) subtract the proceeds of sale from the cost of acquisition of the rights remaining unallowed; and

(b) divide the remainder by the number of previous year which have not expired at the beginning of the year in which the rights are sold.

(v) In case of amalgamation of companies, the amalgamated company (being an Indian company) is entitled to continuation of benefits in the same way as amalgamating company would have enjoyed, if it has not so sold or otherwise transferred the rights.

Similarly, in case of demerger of companies, the resulting company (being an Indian company) is entitled to continuation of benefits in the same way as demerged company would have enjoyed, if it had not so sold or otherwise transferred the rights.

Note : Now, no dedection under this section is allowed.

(I) Deduction in respect of expenditure on know-how (Section 35AB)

Any lump sum consideration paid by the assessee in any previous year relevant to the assessment year commencing on or before 1st April, 1998 for acquiring any know-how for use for the purpose of his business will be allowed as deduction by spreading it equally over six years, namely, the year in which the lump sum consideration is paid and the five immediately succeeding years. With effect from 1.4.98 depreciation on intangible assets has been introduced and charged @25%. In view of this change expenditure under this section is not to be amortised if incurred after the given date. Where the know-how is developed in a laboratory, University or institution etc., the consideration shall be spread equally over 3 years. In case of transfer of business under the scheme of

amalgamation or demerger where amalgamating or the demerged company is entitled to a deduction under this section, then the amalgamated company or the resulting company, as the case may be shall be entitled to claim deduction under this sub- section for the residual period as if the business or the undertaking had continued. For the purpose of this section “know-how” means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including searching for, discovery or testing of deposits or winning of access thereto).

(J) Expenditure on telecom licence (Section 35ABB)

Where any capital expenditure is incurred by the assessee for acquiring any right to operate telecommunications
services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal
instalments over the period for which the licence remains in force, subject to the following:

(a) If the fee is paid for acquiring any right to operate telecommunications services before the commencement of such business, the deduction shall be allowed for the previous years beginning with the previous year in which such business is commenced.

(b) If the fee is paid for acquiring such rights after the commencement of such business the deduction shall be allowed for the previous years beginning with the previous year in which the license fee is actually paid (irrespective of the previous year in which the liability for the expenditure is incurred).

Profit/loss on Sale -

– Where the licence is transferred and proceeds of transfer (sale proceeds) are less than the amount of expenditure incurred remaining unallowed:

(i) Where whole of the licence is transferred in a previous year. Deduction as given below shall be allowed in the previous year in which the licence is transferred.

Expenditure remaining unallowed less sale proceeds.

(ii) Where part of the licence is transferred in a previous year. Deduction as given below shall be allowed in the balance number of relevant previous years.

(expenditure remaining unallowed less sale proceeds) divided by balance number of relevant previous years, i.e., the previous years not expired at the beginning of the year of transfer.

– Where the licence is transferred and the proceeds of transfer (sale proceeds) exceed the amount of expenditure incurred remaining unallowed. Sale proceeds less expenditure remaining unallowed subject to deductions already allowed shall be
chargeable to income tax as profits and gains of the business in the previous year in which licence is
transferred. Consequently, no further deduction in the previous year in which licence is transferred or in any
subsequent previous years is allowed.

Where licence is transferred in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year. – Where under a scheme of amalgamation a telecom licence is transferred by the amalgamating company to the amalgamated company (being an Indian company), then deduction will not be available under this section to the amalgamating company, instead the provisions of this Section (35ABB) will continue to apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

– Similarly in a scheme of demerger a telecom licence is transferred by the demerged company to the resulting
company, then deduction will not be available to the demerged company and will instead apply to the resulting
company as they would have applied to the demerged company if the latter had not transferred the licence.

Further where a deduction for any previous year is claimed and allowed under Section 35ABB, then no deduction under Section 32(1) shall be allowed for the same or any subsequent previous year.

(K) Expenditure on Eligible projects or schemes (Section 35AC)

Section 35AC has been inserted by Finance (No. 2) Act, 1991 from the assessment year 1992-93 onwards. Under this section an assessee is allowed a deduction in computing profits of business or profession in respect of any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme. For this purpose 'eligible project or scheme' means such project or scheme for promoting the social and economic welfare of, or the upliftment of the public as the Central Government may on the recommendations of the National Committee notify in the Official Gazette.

National Committee for this purpose will be the Committee constituted by the Central Government, from amongst the persons of eminence in public life.

In addition to the aforesaid mode of payment a company can claim deduction by expending directly on the
eligible project or scheme.

In order to claim deduction the assessee has to furnish along with his return of income a certificate
– (a) from the public sector company, or local authority or as the case may be association or institution where the payment is made through these bodies.

(b) in any other case (like payment made directly by a company on the eligible projects in scheme) from a Chartered Accountant. in such manner, form and containing such particulars as may be prescribed. Further, a deduction under this section if, is claimed and allowed for any assessment year, disentitles the assessee from claiming deduction in respect of such expenditure under any other provision of this Act for the same or any other assessment year.]

(L) Expenditure of capital nature incurred in respect of specified business (Section 35AD)

(1) An assessee shall be allowed a deduction of capital nature expenditure incurred for any specified business carried on by him during the previous year in which such expenditure is incurred by him. (1A) Where the specified business is of the nature referred to in sub-clause (i) or sub-clause (ii) or sub-clause (v) or sub-clause (vii) or sub-clause (viii) of clause (c) of sub-section (8) and has commenced its operations on or after the 1st day of April, 2012, the deduction under sub-section

(1) shall be allowed of an amount equal to one and one-half times of the expenditure referred to therein.

(2) This section applies to the specified business which fulfils all the following conditions:

(i) it is not set up by splitting up, or the reconstruction, of a business already in existence;

(ii) it is not set up by the transfer to the specified business of machinery or plant previously used for any purpose;

(iii) where the business is of the nature referred to in sub-clause (iii) of clause (c) of subsection (8), such business,

(a) is owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;

(b) has been approved by the Petroleum and Natural Gas Regulatory Board established under subsection

(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 capacityas 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 gudelines as may be prescribed.
(ad) on or after the 1st day of April, 2011, where the specified business is in the nature of developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;
(ae) on or after the 1st day of April, 2011, in a new plant or in a newly installed capacity in an existing plant for
production of fertilizer;
(af) on or after the 1st day of April, 2012, where the specified business is in the nature of setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (52 of 1962);
(ag) on or after the 1st day of April, 2012, where the specified business is in the nature of bee-keeping and production of honey and beeswax;
(ah) on or after the 1st day of April, 2012, where the specified business is in the nature of setting up and operating a warehousing facility for storage of sugar; and
(b) on or after the 1st day of April, 2009, in all other cases not falling under clause (a), clause (aa), clause (ab), clause (ac), clause (ad) and clause (ae)
(6) The assessee carrying on the business of the nature referred to in clause (a) of sub-section (5) shall be allowed, in addition to deduction under sub-section (1), a further deduction in the previous year relevant to the assessment year beginning on the 1st day of April, 2010, of an amount in respect of expenditure of capital nature incurred during any earlier previous year, if –
(a) the business referred to in clause (a) of sub-section (5) has commenced its operation at any time during the period beginning on or after the 1st day of April, 2007 and ending on the 31st day of March, 2009; and
(b) no deduction for such amount has been allowed or is allowable to the assessee in any earlier previous
year.
(6A) Where the assessee builds a hotel of two-star or above category as classified by the Central Government
and subsequently, while continuing to own the hotel, transfers the operation thereof to another person, the
assessee shall be deemed to be carrying on the specified business referred to in sub-clause (iv) of clause (c) of
sub-section (8).

(7) The provisions contained in sub-section (6) of section 80A and the provisions of sub-sections (7) and (10) of
section 80-IA shall, so far as may be, apply to this section in respect of goods or services or assets held for the purposes of the specified business.

(a) an "associated person", in relation to the assessee, means a person,
(i) who participates, directly or indirectly, or through one or more intermediaries in the management or control or capital of the assessee;
(ii) who holds, directly or indirectly, shares carrying not less than twenty-six per cent. of the voting power in the capital of the assessee;
(iii) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or
(iv) who guarantees not less than ten per cent. of the total borrowings of the assessee;
(b) "cold chain facility" means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce;
(c) "specified business" means the any one or more of the following business, namely
(i) setting up and operating a cold chain facility;
(ii) setting up and operating a warehousing facility for storage of agricultural produce;
(iii) laying and operating a cross-country natural gas or crude or petroleum oil pipeline
(iv) building and operating, anywhere in India, a hotel of two-star or above category as classified by the Central Government.
(v) Building and operating anywhere in India, a hospital with at least one hundred beds for patients;
(vi) developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and which is notified by the Board in the behalf in accordance with gudelines as may be prescribed.
(vii) developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;
(viii) production of fertilizer in India;
(ix) setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (52 of 1962);
(x) bee-keeping and production of honey and beeswax; and
(xi) setting up and operating a warehousing facility for storage of sugar
(d) any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if

(i) such machinery or plant was not, at any time prior to the date of the installation by the assessee,
used in India;
(ii) such machinery or plant is imported into India from any country outside India; and
(iii) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee;
(e) where in the case of a specified business, any machinery or plant or any part thereof previously used for any purpose is transferred to the specified business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent. of the total value of the machinery or plant used in such business, then, for the purposes of clause (ii) of sub-section (2), the condition specified therein shall be deemed to have been complied with;
(f) any expenditure of capital nature shall not include any expenditure incurred on the acquisition of any land or goodwill or financial instrument.

(M) Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes (Section 35CCA)

Any sum paid to a rural development fund set up and notified by the Central Government and to the National Urban Poverty Eradication Fund similarly set up and notified qualifies for deduction on fulfillment of certain conditions.

(N) Expenditure by way of Payment to Associations and Institutions for carrying out Programmes of Conservation of Natural Resources (Section 35CCB)

Sums paid on or before 31.3.2002 by an assessee carrying on business or profession to an approved association or institution which has as its object the undertaking of any programme of conservation of Natural resources (or of afforestation w.e.f. the assessment year 1991-92) to be used for such programme, are allowed a deduction of the amount of such expenditure incurred during the previous year. The deduction under this provision is not allowed unless the association or institution is for the time being approved by the prescribed authority. As per Rule 6AAC, the prescribed authority for this purpose is Secretary, Department of Environment, Government of India. Further, the prescribed authority shall not grant such approval for more than three years at a time. Also, where an assessee carrying on business or profession incurs any expenditure by way of payment of any sum to any fund for afforestation as notified by Central Government, such sum is allowed as a deduction (in the previous year) in computing taxable profits.

(O) Expenditure on agricultural extension project (Section 35CCC)

Where an assessee incurs any expenditure on agricultural extension project notified by the Board then, there shall be allowed a deduction of a sum equal to 150% of such expenditure.

(P) Expenditure on skill development project (Section 35CCD)

Where a company incurs any expenditure (not being expenditure in the nature of cost of any land or building) on
any skill development project notified by the Board then, there shall be allowed a deduction of a sum equal to 150% of such expenditure.

(Q) Amortisation of Preliminary Expenses (Section 35D)

Under Section 35D, Indian companies and other non-corporate taxpayers resident in India would be entitled to amortisation of certain preliminary expenses incurred by them at any time after 31.3.1970. The expenditure which qualifies for amortisation should have been incurred by the assessee:

(i) before the commencement of his business,

(ii) if however, the expenditure is incurred after the commencement of business, it is essential that the expenditure should be in connection with the extension or expansion of the undertaking of the assessee or in connection with the setting up of a new unit by the assessee.

Amount of Deduction:

The amount qualifying for amortisation would be allowable as a deduction in five equal instalments beginning with the previous year in which the business of the assessee actually commences or the previous year in which the extension of the present undertaking is completed or the new unit commences production or operation, as the case may be.

Qualifying amount of expenses:

The following items of expenses qualify for amortisation under this section as preliminary expenses:

(i) expenditure incurred by the assessee in connection with the preparation of feasibility report or project report;

(ii) expenses for conducting market survey or any other survey necessary for the purpose of the business of the assessee;

(iii) expenditure for getting engineering services related to the business of the assessee;

(iv) expenses by way of legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;

(v) in the case of a company

(a) expenses by way of legal charges for drafting the Memorandum and Articles of Association of the Company;

(b) expenses for printing the Memorandum and Articles of Association;

(c) expenses by way of fees for registration of the company under Companies Act, and

(d) expenditure incurred in connection with issue for public subscription of shares or debentures of the company, being underwriting commission, brokerage and the charges of drafting, typing, printing and advertisement of the prospectus; and

(vi) such other items of expenses not covered by the list specified above which the Central Board of Direct Taxes may prescribe for the purpose of amortisation under this section.

Note: Work mentioned in (i) to (iii) above must be carried out by assessee himself or by a concern approved by CBDT.

Amount qualifying for deduction:

The maximum amount allowable as preliminary expenses qualifying for amortisation should be restricted to an amount calculated at 5% of (a) the cost of the project, or (b) where the assessee is an Indian Company, at the option of the company, of the capital employed in the business of the company or cost of project.

Cost of the Project

For the purpose of amortisation, the expression "Cost of the Project" in relation to the expenses incurred before the commencement of the business means the actual cost of the fixed assets being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of land and buildings, which are shown in the books of accounts of the assessee as on the last day of the accounting year in which the business of the assessee actually commences. Where the expenses are incurred after the commencement of business either in connection with the extension of the present undertaking or in connection with the setting up of a new unit, the cost of the project should be taken to mean the actual cost of the fixed assets, being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of the land and building which are shown in the books of the assessee as on the last day of the previous year in which extension of the undertaking is completed or the new unit commences production or operations, as the case may be, to the extent to which such fixed assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit of the assessee.

Capital Employed

In the case of company, the capital employed in the business means where preliminary expenses have been incurred before the commencement of the business, the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the accounting year in which the business of the company has actually commenced. In cases where the expenditure has been incurred after the commencement of the business, the capital employed in the business of the company should be taken to be the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the accounting year in which the extension of
the undertaking is completed or, as the case may be, the new unit commences production or operation, to the extent to which the capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or setting up of the new unit of the company.

Meaning of the long-term borrowings

The expression 'long-term borrowings' to be included as part of the capital employed in the business of the company should be taken to mean:

(i) any moneys borrowed by the company from the Government or the Industrial Finance Corporation of India or Industrial Credit and Investment Corporation of India or any other financial institution which is eligible for deduction under Section 36(1)(vii) of the Act or any banking institution; or

(ii) any moneys borrowed or debt incurred by the company in a foreign country in respect of the purchases outside India of capital plant and machinery where the terms of the borrowing provide for repayment of the money borrowed or debt incurred over a period of not less than seven years.

In case of person other than a company or a co-operative society

The allowance towards amortisation of preliminary expenses is subject to the condition that the accounts of the assessee for the year or years in which the preliminary expenses are incurred have been audited by a Chartered Accountant or other accountant specified in Section 288(2) of the Act and, in addition, the assessee furnishes along with his return of income for the first year in which the deduction is claimed the report of audit in the prescribed form, duly signed and verified by the auditor and setting out such other particulars as have been prescribed by the Board for this purpose.

In case of Amalgamation/Demerger

In cases of amalgamation as defined in Section 2(1B) of the Act, the amalgamating company would not be entitled to the allowance towards amortisation of preliminary expenses in the year in which the amalgamation takes 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.

(R) Amortisation of Expenditure in the case of Amalgamation/Demerger (Section 35DD)

The section provides that where an assessee, being an Indian company, incurs expenditure on or after April 1, 1999 wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall be allowed a deduction equal to one fifth of such expenditure for five successive previous years beginning with the previous year in which amalgamation

or demerger takes place. No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

(S) Amortisation of Expenditure in the case of Voluntary Retirement Scheme (Section 35DDA)

The object of this section is to provide amortisation of one-fifth every year from the year in which the expenditure is incurred, of expenditure by way of payment of any sum to an employee in connection with his voluntary retirement. It also provides that no deduction would be allowed in respect of such expenditure under any other provision of the Act.

This provision supersedes the view expressed by the CBDT in its circular dated January 23, 2001, that the expenditure has to be treated as capital expenditure with the result that no allowance would be permissible in regard to this expenditure.

(T) Deduction in respect of Expenditure on Prospecting etc. for certain Minerals (Section 35E)

Section 35E of the Income-tax Act provides allowance to amortise the capital expenditure incurred by an assessee towards prospecting for certain minerals. The benefit of amortisation under this section is available to Indian companies and other non-corporate entities resident in India.

The expenditure qualifying for amortisation would cover expenses incurred by the assessee after 31-3-1970 in relation to the operations towards prospecting for, or extraction or production of any of the 27 minerals or 16 groups of associated minerals specified in the Seventh Schedule to the Income-tax Act. The expenditure incurred by the assessee would qualify for amortisation only if the expenditure in question is incurred by the assessee during the year of commercial production and/or in one or more of the four years immediately preceding that year; in any case the expenditure must have been incurred after 31-3-1970 wholly and exclusively on any of the operations relating to the prospecting for any mineral or group of associated minerals or on the development of a mine or other natural deposit of any such mineral or group of associated minerals. However, any portion of the expenditure which is met directly or indirectly by any other person or authority and sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or right brought into existence as a result of the expenditure should be excluded from the amount of expenses qualifying for amortisation under this section. The assessee would not be entitled for amortisation under this section in respect of the following three items of expenses namely,-

(i) Expenditure incurred on the acquisition of the site of the source of any mineral or group of associated minerals or of any right in or over such site.

(ii) Expenditure on the acquisition of the deposits of such minerals or group of associated minerals or of any right in or over such deposits; or

(iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is available under Section 32 of the Income-tax Act.

(U) Other Deductions

In addition to the various items of expenses and allowances provided by Sections 30 to 35E, Section 36 grants deduction in respect of the following items:

(i) Insurance Premium

(a) The assessee is entitled to the deduction of the amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession.

(b) The amount of premium paid by federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society.

(c) The amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed in this behalf by

– 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 3 of the Insurance Regulatory and Development Act, 1999.

(ii) Bonus

Any amount paid by an employer to his employees as bonus or commission for services rendered would be deductible. This deduction is allowable only in cases where the amount of bonus or commission would not have otherwise been payable to the employees as profits or dividend if it had not been paid as bonus or commission.

Where the bonus is paid during the previous year in respect of an earlier year in terms of an award made during the previous year by the Industrial Tribunal, the deduction will be allowed during the previous year in which the payment is made [Kalyana Mal Mills Ltd. v. C.I.T. (1965) 57 ITR p. 261]. Note that with effect from assessment year 1989-90 ceiling on bonus to be allowed as deduction is proposed to be deleted. At the same time the bonus payment shall be covered by the provisions of Section 43B so that they are allowed as deduction only on actual payment basis.

(iii) Interest on Borrowings

The amount of interest paid by a going concern in respect of capital borrowed for the purposes of business or profession would be allowable as a deduction. Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till thedate on which such asset was first put to use, shall not be allowed as deduction.

For the purposes of this allowance, recurring subscription paid periodically by shareholders or subscribers in mutual benefit societies which fulfil such conditions as may be prescribed under the Income-tax

Rules would be deemed to be capital borrowed and consequently interest thereon would be allowable as a deduction. The deduction allowable to the assessee in respect of interest on borrowings is not in any way related to the application of the borrowed money for capital or revenue purposes. The only conditions are that the borrowing must be genuine and the money borrowed must be utilized by the assessee wholly and exclusively for the purposes of the business. However, interest on capital contributed or loan given by partners of a firm would not be allowable to the firm as deduction since the capital contributed or loan given by the partners does not represent money borrowed by the firm. Similarly, interest on share capital cannot be claimed by the shareholders or allowed to a company as a deduction since share capital does not represent money borrowed by the company. However, interest on debentures would be allowable as a deduction although the money borrowed by way of debentures might have been utilized for investment in capital assets like buildings, machinery, plant or furniture or other assets.

However, if debenture loan is illusory and colourable, interest paid thereon is not allowable as a deduction. Interest on capital borrowed for business, which is yet to be set up is not deductible. But interest on capital borrowed for expansion of business is allowable as a deduction.

Where the assessee firm, carrying on the business of suppliers to Government Department, had to borrow money for the purchase of Government Loan Bonds to obtain preference in securing orders for supply and claimed deduction of interest on such borrowed money it was held that the interest so paid was an admissible deduction under Section 36(1)(iii).

Interest on money borrowed by an assessee for the purpose of payment of income-tax would not be allowable under this section since income-tax liability is a personal liability of the assessee and cannot therefore, be treated as interest on money borrowed for the purposes of the business. Interest paid by the assessee for delayed payment of advance tax is not also deductible under this section because it does not represent interest on money borrowed.

(iiia) Discount on zero coupon bond

Any discount given by the assessee as an employer by way of pro rata amount of discount on a zero coupon bond having regard to the period of life of such bond calculated in the manner prescribed would be deductible as business expenditure.

(iv) Contributions to Recognised Provident Fund, Approved Superannuation Fund

Any sum paid by the assessee as an employer by way of contribution towards recognised provident fund or an approved superannuation fund would be deductible in computing the business income of the employer subject to section 43B. However, the contribution must be fixed on some definite basis by reference to the income chargeable under the head 'Salaries'. This deduction is subject to the limits and conditions specified for this purpose under Income-tax Rules. According to Rule 88, the amount to be allowed as a deduction on account of an initial contribution which an employer may make in respect of the past services of an

employee admitted to the benefits of a fund shall not exceed 25% of the employee's salary for each year of his past services with the employer as reduced by the employer's contribution, if any, to any provident fund (whether recognised or not) in respect of that employee for each year. Where the company paid fixed salary plus commission at a fixed percentage of turnover achieved by the employee and contributed to the recognised provident fund on the salary plus commission, it was held to be allowable. [Gestetner Duplicators (P.) Ltd. v. C.I.T. (1979) 117 ITR p.1 (S.C.)].

(iva) 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.

(v) Approved Gratuity Fund

Any sum paid by the assessee as an employer by way of contribution to an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust would be deductible as business expenditure (subject to section 43B). In the case of contributions to gratuity fund, normally the amount of contribution calculated on actuarial basis would be deductible although the liability to pay gratuity to employees may arise at a future point of time as and when the employee retires or dies.

(va) Deposit of the Employee's contribution by the Employer in relevant funds or or before date

Deduction is allowed to an assessee in respect of any sum received by him from any of his employees to which the provisions of sub-clause (x) of clause 24 of Section 2 apply i.e., Contribution to any provident fund, Superannuation fund, fund set-up under E.S.I. Act or any fund for welfare of employees, if such sum is credited by the assessee to the employee's account in the relevant fund or funds on or before the due date. "Due date" for the purposes of this clause means the date by which the assessee is required, as an employer to credit an employee's contribution to the employee's account in the relevant fund under any Act, rule, order or notification issued thereunder or under any standing order, award, contract of service or otherwise.

Hence, the contributions received by an employer towards provident fund, an approved superannuation fund or any fund under the ESI Act or any other fund are allowed to an assessee as deduction only if such amount is "credited" by the employer to the employee's account on or before the "due" date. The employer cannot, therefore, claim any deduction in respect of such accounts without "crediting" the employees' account with the money. If the amount is not deposited in time then it will not be allowed as deduction and employer's share will be treated as income.

(vi) Animals

In respect of animals, which have been used for purposes of the business or profession of the assessee otherwise than as stock-in-trade, a deduction would be allowable in the year in which the animals have died or have become permanently useless for the purpose of the business. The

amount of allowance would be the difference between the actual cost of the animals to the assessee and the amount, if any, realised in respect of the carcasses of the animal.

(vii) (a) Bad Debts [Section 36 (1)(vii) and (2)]

The amount of any debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowed to be deducted. The deduction for bad debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which theamount of such debt or part thereof is written off or, of any earlier previous year, or, represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. In this respect, the following conditions are pre-supposed:

1. Relationship of debtor and creditor

A bad debt pre-supposes the existence of a debt, and therefore, a relationship of debtor and creditor is essential. Unless there is an admitted debt and it becomes irrecoverable, it cannot be written off as a bad debt. C.I.T. v. Vanguard Insurance Co. Ltd. (1974) 97 ITR 546, 552 (Madras).

2. The debt must be incidental to the business or profession

The debt which is claimed as bad must be incidental to the business or profession carried on by the assessee. If the debt is not incidental to the business or profession, such a debt cannot be deducted as a bad debt. For example, in a solicitor's profession, it is not a part of that profession to advance money to clients who may require financial help to purchase properties, farms or stocks. It is immaterial that the advance is made by a solicitor for the purposes of attracting clients and to induce them to remain with him. Any loss arising from such a lending is not deductible. On the other hand, payment of legal expenses of a law-suit under the client's instruction is incidential to the profession. If any amount remains unrecovered in respect of such expenses, it can be allowed as a bad debt against the profits of the profession.

Similarly, where an assessee carries on business in an agricultural produce and has to advance money to growers under an agreement to have the advances adjusted towards the price of the produce to be delivered to the assessee, the losses incurred in the event of such advance becoming irrecoverable, arise out of the business and can be deducted as bad debt C.I.T. v. Abdullakadar (1961) 41 ITR 545, 551 (SC).

In the business of money-lending, each and every lending may not be in the ordinary course of business. For example, where a money-lender invests his capital or accumulated profits in government securities, mortgages and debentures and suffers a loss on the investment, such a loss is capital loss and cannot be deducted as bad debt against the profits and gains of moneylending business. Sir Chinubhai Madhaval v. C.I.T. (1937) 5 ITR 210 (Bom.). Debts due from retiring partners are capital sums and the loss of such amounts cannot be written off and claimed as bad debts. Girdhari Lal Gian Chand v. C.I.T. (1971) 79 ITR 561 (All.).

3. Deduction in the year of writing off

No such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee for the

previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. The age of a debt is no doubt a relevant factor to be taken into consideration, but a time-barred debt is not necessarily bad: neither is a debt which is not time-barred necessarily good. BCGA (Punjab) Ltd. v. C.I.T. (1937) 5 ITR 279. A debt may have become time-barred but an assessee may not opt to claim it as bad if he relies on the honesty and integrity of the debtor. On the other hand, a debt may become bad even if it may not be time-barred. It is not necessary that a debt can be claimed as bad only if an assessee has failed to recover it through a court of law. Legal unenforceability of the claim does not prevent the amount from being a bad and irrecoverable debt for the purposes of taxation. Badrinarayan Balkrishan v. C.I.T. (1968) 69 ITR 323 (A.P.). Taking into account the precarious and shaky financial position of the debtor, a creditor may opt not to institute legal proceedings and waste his good money after bad money. The assessee must satisfy the Assessing Officer that in fact the debt or the loan has become irrecoverable in the accounting year in which a claim for deduction is made in respect thereof and it has been written off from the book.

4. Adjustment in the year of recovery

The deduction in respect of a bad debt is based on a mere estimate. Therefore, if the amount of final recovery and the amount allowed as bad debt in respect of a bad debt falls short of the amount of such debt, such deficiency is further deductible in the year of final recovery. For example, an assessee claims a debt of ` 25,000 as bad in 1987-88. The Assessing Officer accepted a claim of ` 12,000 only. As a final settlement, the assessee recovered ` 8,000 in 1989-90 in respect of such debt. The amount of final recovery (` 12,000 + ` 8,000) falls short of the amount of the debt (i.e. ` 25,000). Such deficiency of ` 5,000 is deductible in the year in which the assessee writes it off in his books of account.

5. No allowance for bad debts of a discontinued business

No deduction is allowed for a bad debt of a business which has been discontinued before the commencement of the accounting year. Such a bad debt cannot be deducted from the profits of a separate existing business. Kameshwar Singh v. C.I.T. (1947) 15 ITR 248. An assessee can claim the deduction for a bad debt of a business which is carried on by the assessee for at least sometime during the previous year. It is not necessary that the business should be carried on throughout the previous year.

6. Successor not entitled to write off predecessor's debts

The deduction of a bad debt can be claimed if the debt had been taken into account in computing the income of the assessee of that previous year or an earlier previous year unless it represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. Therefore, the debts of a predecessor-in-business may not be deductible in the hands of a successor-in-business. Thus, where the entire business of a partnership, after retirement of one

of the partners, was taken over by the other partner who continued with the same stock-in-trade, he is not entitled to claim a debt of the partnership as bad if the same is not realised. However, in certain cases even a successor is entitled to write off predecessor's debts. On dissolution of the firm, if one of the partners takes over the business with all assets and liabilities and carries it on as successor, he is entitled to allowance when a debt originally due to firm becomesbad. It is merely an incident flowing from the transfer of the business together with its assets andliabilities, from the previous owner to the transferee. It is a right which should, on a proper appreciation of all that is implied in a transfer of a business be regarded as belonging to the new owner. (CIT v.T. Veerabhadra Rao, K. Koteswara Rao & Company (1985) 155 ITR 152 (SC). If business is carried on without any break, change merely occurring in persons carrying on business would not disentitle business to claim deduction under this Section [E.A.V. Krishnamurty & Son v. CIT (1985) 152 ITR 640 (Mad.)].

7. No Deduction for provision for bad & doubtful debt:

Any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee. [Explanation 2 to section 36(1)(vii)]

(vii) (b) Provisions for bad and doubtful debts in case of Scheduled or non-scheduled Banks [Section 36(1)(vii) and (viia)] A scheduled bank or non-scheduled bank in India is allowed deduction in respect of provision made for bad and doubtful debts in accordance with the following provisions :

(i) Bank having no branch is rural area : The bank which have no branch in rural area shall be allowed deduction in respect of provision for bad and doubtful debts as follows :

– provision made for bad and doubtful debts

– 7.5% of gross total income

whichever is lower.

(ii) Bank having branch in rural area :

The following amount is allowed as deduction :

(a) provision made for bad and doubtful debts or

(b) (i) 7.5% of gross total income and

(ii) 10.5% of the aggregate average advances made by the rural branch whichever is less

Average advances qualifying for the deduction will be computed in the following manner as per Rule 6ABA: (a) The amount of advances made by each rural branch as outstanding at the end of the last day of each month comprised in the previous year is to be aggregated separately.

(b) The sum so arrived in case of each branch is to be divided by the number of months for which the outstanding advances have been taken into account for the purose of clause (a).

(viii) Special reserves created by Financial Corporations

Special reserve created by financial corporation engaged in providing long-term finance for industrial or agricultural development in India or development of infrastructure in India or by a public company formed and registered in India with the main object of carrying on the business

of providing long-term finance for construction or purchase of houses in India for residential purpose, is deductible to the extent of 40% of income from such activity. Condition to be fulfilled to get the above deduction:

(i) The aggregate of the amounts carried to such reserve account from time to time do not exceed twice the amount of the paid-up share capital of the corporation, or the company and its general reserves.

In this clause –

(a) “financial corporation” shall include a public company and a government company;

(b) “public company” shall have the meaning assigned to it in Section 3 of the Companies Act, 1956; and

(c) “government company” shall have the meaning assigned to it in Section 617 of the Companies Act, 1956.

In terms of Section 41(4A) any withdrawal from such special reserve would be deemed to be the profits and gains of business even if the business is closed down.

(ix) Expenditure on Family Planning

In the case of companies any bona fide expenditure incurred for the purpose of promoting family planning amongst the employees would be deductible. In cases where the expenditure is wholly or partly in the nature of a capital expenditure, the deduction allowable to the company in respect of the capital expenditure would be a sum equal to 1/5th in each year of the expenditure in respect of the accounting year in which it was actually incurred and 1/5th of each of the subsequent four years immediately following that year. The unabsorbed part of the capital expenditure on family planning incurred by the companies would be treated in the same way as unabsorbed capital expenditure on scientific research or unabsorbed depreciation and could be carried forward indefinitely without any time limit in cases where the profits of the assessee are not sufficient to cover the amount as allowable.

(x) Expenditure incurred by Corporation or a Body Corporate

Any expenditure which is not being in the nature of capital expenditure incurred by a corporation or a body corporate, by whatever name called, constituted or established by a Central, State or Provincial Act, is notified by the Central Government in the official Gazette and the expenditure incurred for the objects and purposes authorised by the Act under which such corporation or body corporate was constituted or established, is deductible.

(xi) Banking Cash Transaction Tax

Any amount of Banking Cash Transaction Tax paid by the assessee during the previous year on the taxable banking transactions entered into by him are allowed as deduction. “Banking Cash Transaction Tax” and “Taxable Banking Transaction” shall have the same meanings respectively assigned to them under Chapter VII of the Finance Act, 2005;

(xii) Any sum paid by a public financial institution by way of contribution to notified Credit Guarantee Fund Trust for small industries is allowed as deduction.

(xiii) Securities Transaction Tax

An amount equal to the securities transaction tax paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year, if the income arising from such taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession is allowed as deduction.

"Securities Transaction Tax" and "Taxable Securities Transaction" shall have the meanings respectively assigned to them under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004);

(xiv) Commodities Transaction Tax

An amount equal to the Commodities Transaction Tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession" is allowed as deduction.

(V) Other Expenses not covered by the Previous Deductions

Section 37(1) of the Income-tax Act provides for allowance in respect of any other item of expenditure not covered by any of the provisions contained in Sections 30 to 36 discussed above. This deduction is subject to the following conditions:

(i) The expenditure must have been laid out or expended by the assessee wholly and exclusively for the purposes of his business or profession.

(ii) The expenditure should not be in the nature of a capital expenditure.

(iii) The expenditure should not represent any item of personal expenditure of the assessee.

(iv) The deduction claimed should not cover any of the items of the expenditure which are specifically disallowed under the Act.

Points for Consideration for Allowance of Expenditure as Deduction

– For the purpose of allowance of expenses under this section, it is not essential that the expenditure in question must necessarily have resulted in the earning of income or profits by the assessee.

– It is enough if the expenditure is incurred wholly and exclusively for the purposes of the business although it is not necessary for the assessee to prove that the expenditure is unavoidable or that the expenditure has been incurred out of business necessity.

– The assessee would be entitled to the allowance if he could prove that the expenditure is justified and has been incurred by reason of commercial expediency. Whether the particular expenditure is incurred in compliance with some other law for the time being in force or not the assessee would still be entitled to the deduction.

– Capital expenditure has been specifically disallowed by the provisions, care must be taken to ensure that a proper distinction is made between expenses of a capital nature and those of revenue nature because only revenue expenses would qualify for allowance under this section. The broad test is to determine whether the expenditure has resulted in the

acquisition of a capital asset or property. To put it in other words, whether such expenditure has resulted in giving to the assessee a benefit of an enduring nature. The expression "enduring" used in this context should not be mistaken to mean ever-lasting or eternal nature but if the benefit of an expenditure is so transitory or ephemeral as to be not in existence for some period the expenditure in question must be treated as being of a revenue nature.

– Care should also be taken to distinguish between expenses incurred for the purpose of the business to earn income and payments which are alleged to be expenses which, however, are really in the nature of diversion of profits.

– The allowability or otherwise of an item of expenditure under this section would be a question of facts and law and the ultimate conclusion would be the decision of the High Court 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 religions nature.
(x) Recurring expenses incurred on imparting basic training to apprentices under the Apprentices Act, 1961 is deductible.
(xi) Initial expenditure on the first installation of fluorescent tube lights is treated as Capital expenditure and hence not deductible but all subsequent expenditure for replacement of tubes is treated as revenue expenditure and hence deductible.
(xii) Loss through embezzlement by an employee is deductible.
(xiii) Professional tax paid by a person carrying on business or trade is allowed as deduction.
(xiv) Annual listing fee paid to stock exchange is allowed as deduction.
(xv) Expenses incurred on Civil defence measures as specified by the Board, even when there is no emergency, is deductible.
(xvi) Brokerage paid for raising loan to finance business. (xvii) Stamp and registration charges for the purpose of entering into agreement for obtaining overdraft facilities.
(xviii) Security deposited with postal authorities for telex connection deductible as business expenditure. However, when the amount is returned by postal authorities, when the telex connection is finally closed, the refund shall be treated as an income of the assessee of the year in which the amount is refunded.
(xix) Compensation payable as a result of negligence in carrying on a business or termination of an employee, director or agent.
(xx) Compensation to an employee for injury sustained or accident met with while on duty.
(xxi) Royalty paid for mining, patents or copyrights.
(xxii) Insurance premiums: Premium for insurance of building, plant, machinery, furniture, stock or stores are allowable under specific sections, e.g., premium paid by a businessman under a policy insuring its employees or experts against death or injury, or insuring the employer against liability for compensation in respect of accidents to its workmen or against loss of trading licence.

(xxiii) Penalty paid by the assessee for saving from confiscation of the goods which he has purchased from a third-party without knowing that they had been illegally imported.

(xxiv) Pension, gratuity or other voluntary payment made to the employees are deductible but a gratuity paid to a single employee when it was not the practice of the business was treated as disallowable expense. In the same way voluntary pensions and lump sum payments made by a company to its employees on its winding up were not allowed.

(xxv) Bona fide expenditure of a revenue nature incurred for the welfare of employees on its winding up was not allowed.

(xxvi) Excessive price paid out of extra commercial considerations shall be disallowed.

(xxvii) Sum paid by the assessee as a surety when it is not part of his business shall be disallowed.

(xxviii) Presents given to employees by way of gift and not as perquisites for services rendered, shall be disallowed.

Section 37(2B) Advertisement Expenditure : Deduction is not available is respect of expenditure incurred by
an assessee in any souvenir, tract, pamphlet or the like published by a political party.

Certain Allowable Losses

Losses which are directly incidental to the business or profession of the assessee are allowable. Following are some examples of such losses:

(1) Robbery or Dacoity: Loss caused by robbery or dacoity is not deductible. But, if it is incidental to business it will be allowed as a deduction and this depends upon the specific circumstances and conditions. For example, if cash is sent for disbursement at different centers by a sugar factory in rural area, it is incidental to business and is, therefore, allowed. Any loss due to robbery in a bank will be allowed as the bank is under an obligation to maintain some cash outside the storeroom for payments.

(2) Embezzlement, Theft, etc.: The loss of money due to embezzlement by an employee handling the funds of the business while discharging his official duties is allowed as deduction. It is deductible when discovered. When an employee goes to bank to deposit the cash or takes cash with him f or disbursement and he takes away the money for his own use, even then, the loss is allowable. Theft by a cashier, who is incharge of cash is also an allowable loss. A theft committed either by an employee or by someone else by breaking open into the business premises after office hours, is also allowable.

(3) Loss due to Non-recovery of advances: If it is the practice in a business to give advance money to the suppliers and if the supplier neither supplies the order nor refunds the advance money, the loss sustained by the assessee is incidental to business and is, therefore, allowable.

EXPENSES RESTRICTED/DISALLOWED (SECTION 40 AND SECTION 40A)

(a) Expenses Disallowed (Section 40)

The following amounts shall not be deducted in computing the income chargeable under the head "profits and gains of business or profession:

(i) Interest, royalty, fees for technical services payable outside India: Under Section 40(a)(i), deduction is not allowed in respect of any interest (not being interest on a loan issued for public subscription before 1.4.1938), royalty, fees for technical services or other sum chargeable under the Income-tax Act, which is payable outside India or in India to a non-resident, not being a company or to a foreign company and on which tax has not been deducted or after deduction, has not been paid before the expiry of the time prescribed under Sub-section (1) of Section 200. In case where tax is paid or deducted in a subsequent year, the benefit of deduction from profit and gains from business and professional income will be allowed in computing the income of the previous year in which such tax has been paid.

(ii) TDS not deducted on certain payments: Any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139.

Provided that where in respect of any such sum, tax has been deducted in after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid. Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso.

(iii) Rate or Tax Paid on Profits: Under Section 40(a)(ii), any sum paid by the assessee on account of any tax or rate levied on profits on the basis of or in proportion to the profits and gains of any business or profession, would be disallowed in full. For example, income-tax, foreign income-tax or a professional tax levied under the Municipal Act on persons who exercise a profession, trade or calling within the municipal limit shall be disallowed.

Explanation 1 to sub-clause (ii) of clause (a) of Section 40 has been inserted to clarify that any sum paid outside India and eligible for relief of tax under Section 90 or deduction from the Income Tax payable under Section 91 is not allowable and deemed to have never been allowable as a deduction under Section 40 of the Income Tax Act. However, the tax payers will continue to be eligible for tax credit in respect of Income Tax paid in a foreign country in accordance with the provisions of Section 90 or Section 91 as the case may be.

Explanation 2 has been inserted w.e.f. 1.6.06 to provide that any sum paid outside India and eligible for relief of tax under new Section 90A will not be allowed as a deduction in computation of profit and gains from business or professions.

(iv) Wealth Tax [Section 40a(iia)]: Any wealth-tax paid or payable by the assessee in respect of his business assets would be totally disallowed. It is immaterial whether the wealth-tax is assessed and payable in India or in foreign country in respect of the business assets of the assessee.

However, any tax on business assets (other than wealth-tax) is deductible. [Kawasaki Kissen Kaisha Ltd. v. C.I.T. (1975) 99 I.T.R. p. 7 (S.C.). Hence, tax paid on tea garden lands under U. P. Large Land Holding Tax Act, 1957 is deductible. [Dehra Dun Tea Co. Ltd. v. C.I.T. (1973) 88 I.T.R. p. 197 (S.C.)].

(v) Amount paid by way royalty, licence fee, service fee, privilege fee, service charge by State Government undertaking to State Government [Section 40(iib)]

Any amount

(A) paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or

(B) which is appropriated, directly or indirectly, from, a State Government undertaking by the State Government.

In simple words, any amount paid by way of fee, charge, etc., which is levied exclusively on, or any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government, shall not be allowed as deduction for the purposes of computation of income of such undertakings under the head “Profits and gains of business or profession”.

State Government undertaking includes –

(i) a corporation established by or under any Act of the State Government;

(ii) a company in which more than fifty per cent. of the paid-up equity share capital is held by the State Government;

(iii) a company in which more than fifty per cent. of the paid-up equity share capital is held by the entity referred to in clause (i) or clause (ii) (whether singly or taken together);

(iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or indirectly, including by virtue of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

(v) an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.

(vi) Salaries [Section 40a(iii)]: Any payment which is chargeable under the head “salaries” if it is payable –

(A) outside India; or

(B) to a non-resident

and if the tax has not been paid thereon or deducted thereon under Chapter XVIIB of the Act.

(vii) Payment to Provident Funds etc. [Section 40a(iv)]: Any payment to a Provident Fund or other fund established for the benefit of employees of the assessee would be disallowed in cases where the assessee (employer) has not made effective arrangements to secure

deduction of tax at source from any payment made from the fund which are chargeable to tax under the head 'salaries' in the hands of the employees.

(viii) Payment of tax on non-monetary perquisites [Section 40a(v)]: Tax actually paid by an employer under Section 10(10CC) shall not be deducted in computing the income chargeable under the head "Profit and gains of business or profession".

(ix) Payment to Partners: The new provision of Section 40(b) which is substituted by the Finance Act, 1992 with effect from the assessment year 1993-94, provides as follows:

In the case of a firm which is assessable as such:

(a) any payment of salary, bonus, commission or remuneration by whatever name called to a partner other than a working partner would not be allowed as deduction in the hands of the firm;

(b) any remuneration paid to a working partner or interest paid to any partner, which is not authorised by or not in accordance with the terms of the partnership deed would not be allowable deduction in the hands of the firm;

(c) any remuneration paid to a working partner or interest paid to any partner which is authorised by or is in accordance with the terms of the partnership deed but which relates to any period falling prior to the date of such partnership deed would not be allowable. However, in relation to any payment of remuneration to the partner during the previous year relevant to the assessment year 1993-94, the terms of the partnership may at any time during the said previous year, provide for such payment.

(d) any interest which is paid in accordance with the terms of the partnership deed and relates to any period falling after the date of such partnership deed but which is in excess of simple interest @ 12% p.a., w.e.f. 1.6.2002 would not be allowable.

Further, interest paid by the firm to a person in his representative capacity (i.e. on behalf or for the benefit of any other person) and the interest paid by the firm to the person who is so represented shall also be subject to the limit laid down in this clause.

However, where a person is a partner in his representative capacity in the firm, the interest paid to him by the firm otherwise than as partner in a representative capacity will not be subject to the limit laid down in this clause. Again, where a person is a partner in a firm in his own capacity (and not as a partner in a representative capacity), interest paid by the firm to him shall not be taken into account for the purposes of this clause if such interest is received by him on behalf of or for the benefit of any other person.

(e) any remuneration to a working partner which is authorised by and is in accordance with the terms of the partnership deed and in relation to any period falling after the date of partnership deed is an allowable deduction subject however, to the condition that the maximum amount of such payment made to all the partners during the previous year should not exceed the limits given below:

Quantum of Book Profit Amount

(a) Upto ` 3,00,000 or in ` 1,50,000 or 90% of the Book case of a loss profit, whichever is more

(b) on the balance 60%

For the purposes of this clause, 'working partner' means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner; and

'Book profit' means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in chapter IV-D (i.e. Sections 28 to 44D) as increased by the aggregate amount of remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.

(x) Payment by AOPs / BOIs [Section 40(ba)]: In the case of an association of persons or body of individuals (other than a company or a Co-operative Society or a society registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India) any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such association or body to a member of such association or body shall not be allowed as a deduction.

As per explanation 1 to clause (ba) of Section 40, where interest is paid by the association or body to any member thereof, who has also paid interest to the association or body, the disallowance shall be restricted to the amount paid by the association or body to the member, after deducting therefrom the amount paid by the member to the association or body.

Explanation 2 further specifies that in the case of a member in a representative capacity, the interest paid by the association or body to such a person in his individual capacity and not as in his representative capacity, shall not be taken into account. However, any interest paid to such person in his representative capacity shall be taken into account.

Where an individual is a member otherwise than as a member in a representative capacity of an AOP or BOI, interest paid to such person by the AOP or BOI shall not be taken into account for the purposes of this clause if such interest is received by the person on behalf of or for the benefit of any other person.

(b) Expenses Restricted

(1) Payment to Relatives or Associates [Section 40A(2)]: Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person specified below and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable, having due regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is considered to be excessive or unreasonable must be disallowed in computing the assessee's income from business or profession. However, no disallowance, on account of any expenditure being excessive or unreasonable having regard to the fair market value, shall be made in respect of a specified domestic transaction referred to in section

92BA, if such transaction is at arm's length price as defined in clause (ii) of section 92F.

Meaning of specified domestic transaction (Section 92BA)

For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely : –

(i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;

(ii) any transaction referred to in section 80A;

(iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

(vi) any other transaction as may be prescribed, and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.

The specified persons, the payments to whom may fall for disallowance under this section are the following:

(a) Where the assessee is an individual - any relative of the assessee.

(b) Where the assessee is a company, firm, association of persons or H.U.F. any director of the company, partner of the firm, member of the association or family, or any relative of such director, partner or member.

(c) Any individual who has a substantial interest in the business or profession of the assessee or any relative of such individual.

(d) A company, firm, association of persons or H.U.F. having substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family or any relative of such director, partner, or member as the case may be or any other company carrying on business or profession in which the first mentioned company has substantial interest.

(e) A company, firm, association of persons or H.U.F. of which a director, partner or member, as the case may be, has substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family or any relative of these persons.

(f) Any person who carries on a business or profession in cases where the assessee is an individual or any relative of the individual or a person having substantial interest in the business or profession of that person or where the assessee is a company, firm, association of persons or H.U.F. any director of such company, partner of such firm, member of the association or family, or any of their relatives who has a substantial interest in the business or profession of that person.

For the purpose of this disallowance, a person must be deemed to have substantial interest in a business or profession - (i) in cases where the business or profession is carried on by a company, if such person is the beneficial owner at any time during the relevant accounting year of equity shares carrying not less than 20% of the total voting power, and (ii) in other cases, if such person is at any time during the accounting

year, beneficially entitled to not less than 20% of the profits of such business or profession.

(2) Cash Payments exceeding ` 20,000 [(Section 40A(3)]:

Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payeee cheque drawn on a bank or account payeee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.

Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day, exceeds twenty thousand rupees:

Provided that no disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3) and this sub-section where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

Provided further that in the case of payment made for plying, hiring or leasing goods carriages,the amount shall not exceed thirty-five thousand rupees instead of twenty thousand rupees.

Under Rule 6DD of the Income-tax Rules, the following categories of payments are exempt for the purposes of this requirement. Consequently, the provisions of Section 40A(3) do not apply to the following cases and circumstances:

(i) Payments which are made to the Reserve Bank of India, State Bank of India or other banking institutions, including co-operative banks and land mortgage banks, primary credit societies, Life Insurance Corporation of India, Unit Trust of India and certain specified institute providing Industrial Finance.

(ii) Payments, which under the contracts entered into prior to 1.4.1969 have to be made only in legal tender.

(iii) Payments made to the Central or State Governments which under the Rules framed by the Government are required to be made in legal tender.

(iv) Payments in villages and towns having no banking facility, to persons ordinarily residing or carrying on business or profession in such villages or towns.

(v) Payments by means of book adjustment by the assessee in the account of the payee against money due to the assessee for any goods supplied or services rendered by him to the payee.

(vi) Payments made by any Letter of Credit arrangement through bank, a mail or telegraphic transfer through bank, a book adjustment from any

account in a bank to any other account in that or any other bank and a bill of exchange made payable only to a bank.
(vii) Payments of terminal benefits such as gratuity, retrenchment compensation, etc. not exceeding ` 50,000.
(viii) Payments made to cultivators, growers or producers for the purchase of agricultural or forest produce, animal husbandry products including hides and skins, products of dairy or poultry farming, products of horticulture or fish, products of cottage industry run without the aid of power.
(ix) Where the payment is made to an employee temporarily but for a minimum period of fifteen days in a place other than his normal place of duty or on a ship provided tax has been deducted at source in terms of Section 192 of the Act and provided further that such employee has no bank account at such place of temporary posting or ship.
(x) Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike.
(xi) Where payment is made to an agent who in turn is required to make payment in cash for goods or services on behalf of the assessee.
(3) Provision for Gratuity [Section 40A(7)]: No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason. However, any provision made by the assessee for the payment of a sum by way of any contribution towards an approved gratuity fund or for the purpose of payment of any gratuity that has become payable during the previous year shall be allowed.
Where any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason has been allowed as a deduction in computing the income of the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way of gratuity to any employee shall not be allowed as a deduction in computing the income of the assessee of the previous year in which the sum is so paid.
(4) Restriction on contribution by employers to non-statutory funds [Sections 40A(9), (10) and (11)]:
With a view to discouraging creation of irrevocable or discretionary trusts funds, companies, associations of persons, societies, etc. the Finance Act, 1984 has provided that no deduction shall be allowed in the computation of taxable profits in respect of any sums paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals or society or any other institution for any purpose, except where such sum is paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals or society or any other institution for any purpose, except where such sum is paid or contributed (within the limits laid down under the relevant provisions) to a recognised provident fund or an approved gratuity fund or an approved superannuation fund or for the purposes of and to the extent required by or under any other law.

It is further provided that where the Assessing Officer, is satisfied that the fund, trust, company, association of persons, body of individuals, society or other institution referred above has, before March 1, 1984 bona fide laid out or expended any expenditure (not being in the nature of capital expenditure) wholly or exclusively for the welfare of the employees of the assessee out of the sum referred above, the amount of such expenditure shall, in case no deduction has been allowed to the assessee in respect of such sum, be deducted in computing the business income of the assessee of the previous year in which such expenditure is so laid out or expended. It is also provided that where the assessee has before March 1, 1984, paid any sum to any fund, trust, company, association of persons, body of individuals, society or other institutions, then notwithstanding anything contained in any other law or in any instrument, he would be entitled: (a) to claim the unutilised amount be repaid to him and where any claim is so made, the unutilised amount shall be repaid, as soon as may be, to him; and

(b) to claim that land, building, machinery, plant and furniture acquired or constructed by the fund, trust, company, association of persons, body of individuals, society or other institution out of the sum paid by the assessee, be transferred to him and where any claim is so made, such asset shall be transferred, as soon as may be to him.

The aforesaid provisions took effect retrospectively from 1st April, 1980, and accordingly, apply in relation to the assessment year 1980-81 and subsequent years.

(c) Disallowance of unpaid statutory liability (Section 43B)

Under the income-tax law, a person carrying on a business or profession can account for his income either on cash or mercantile basis. The latter, however, have to reckon with the restrictions contained in Section 43B. This section cuts into the freedom of a business to claim certain specified expenses on due basis. The section has broadly divided the targeted expenses into two i.e., according to section 43B even if an assessee maintains books on mercantile system then he will be allowed exemption of the following expenses only on payment basis. In the first category are:

(a) taxes, duties, cess or fees payable under any law;

(b) bonus and commission to employees;

(c) interest to public financial institutions, state financial corporations, state industrial investment corporations and to scheduled banks in respect of term loans or advances;

(d) leave encashment.

(e) any sum payable by employer by way of contribution to provident fund or super annuation fund or any
other fund for welfare of employees.

These four sets of expenses outstanding at the end of the previous year would be allowed as deduction only to the extent they have been actually paid on or before the due date of filing the income-tax return failing which they would be allowed in the previous year they have been actually paid. Where interest as stipulated in (d) above is converted into a loan, borrowing or advance and is not paid, interest so converted will not be treated as having been actually paid, and accordingly, will not be

allowed as a deduction from business income. The second category deals with employers' contribution to provident fund superannuation fund, gratuity fund or any other fund for the welfare of employees. No deduction on this account shall be allowed unless payment is made to the appropriate authority like the Provident Commissioner in case of PF contribution on or before the due date set out in the relevant statute like the PF Act. In case the payment was made otherwise than by cash, the sum should have been realised within 15 days of such due date. For example, if PF contributions are to be handed over to the relevant authority within a month from the end of the month in which it was deducted from employees' salary and the employer for the month of August '99 deductions makes the payment say in the month of October '99, he will lose the benefit of deduction in so far as contributions to PF for the month of August '99 are concerned.

However, Finance Act, 2003 has omitted the second proviso and therefore PF and ESI contribution will be allowed as deduction even if they are not paid within due date specified under relevant Acts.

DEEMED PROFITS

Section 41 of the Income-tax Act enumerates items of notional income which are deemed to be income from business or profession chargeable to tax. The liability to tax in respect of deemed profits would arise not only during the existence of the business but also after its discontinuance. The items of deemed profits are enlisted below:

(i) Remission of Liability or Recoupment of Loss or Expenditure: Where any allowance or deduction has been made in the assessment for any year in respect of losses, expenditure or trading liability incurred by the assessee and subsequently the assessee or his/its successor in business has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof during any subsequent accounting year, the amount so obtained or the value of the benefit so accruing to the assessee or his/its successor in business as the case may be, must be deemed to be the profits and gains of business or profession and must be charged to tax as the income of the assessee or his/its successor in business as the case may be for the year in which the remission or cessation takes place.

This tax liability would arise irrespective of the fact whether the business or profession in respect of which the allowance or deduction has been made is being continued to be carried on by the assessee in the year of remission of liability or not. For instance, if sales tax is paid by the assessee in the year 1998-99 and the assessee gets a refund of sales-tax previously paid in the year 1999-2000, the refund would be taxable as the assessee's income of 1999-2000. But the taxability of any deemed profit on account of remission of liability or recoupment of loss would arise only if the liability in question or the amount of the loss was previously allowed as a deduction in computing the business income of the assessee. For instance, if the income-tax assessment for the year in which the expenditure or loss was claimed was made 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.

(2) "sold" includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian Company.

(iv) Recovery of Bad Debts: Where the assessee claims a deduction in any year in respect of a debt which has become bad or irrecoverable and the Assessing Officer allows a deduction to the extent of the bad debts, if subsequently the assessee recovers either the full amount of the debt which was previously written off as bad or part thereof, the amount so recovered would be chargeable to tax as the business income of the assessee in the year of recovery. But if the amount claimed by the assessee as bad debt was previously disallowed by the Assessing Officer on the ground that it had not actually become bad or it was not written

off by the assessee, when the money is recovered, there would be no liability to tax in respect thereof. In cases where the Assessing Officer had allowed only a part thereof as bad, in the subsequent year of recovery, the tax liability under this section must be on the amount of difference between the amount recovered and the bad debt disallowed by the Assessing Officer.

(v) Withdrawal of any amount from special reserve: Where a deduction has been allowed in respect of any special reserve created and maintained under clauses (viii) of Sub-section (1) of Section 36 any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income tax as the income of the previous year in which such amount is withdrawn.

Where any amount is withdrawn from the special reserve in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

(vi) Set off of Losses of a Defunct Business against Deemed Profit: Where the business or profession referred to in this section is no longer in existence and there is income chargeable to tax under points (i), (ii), (iv) and (v) given above in respect of that business or profession, any loss, not being a loss sustained in speculation business, which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall as far as may be, be set off against the income chargeable to tax under the sub-section aforesaid.

SPECIAL PROVISION FOR DEDUCTIONS IN THE CASE OF BUSINESS FOR PROSPECTING ETC. FOR MINERAL OIL (SECTION 42)

For the purpose of computing the profits and gains of any business of prospecting for or the extraction or production of mineral oils in relation to which the Central Government has entered into an agreement with any person for the association or participation in such business of the Central Government, the assessee is entitled to an allowance over and above the various items of allowances and deductions permissible under the Income tax Act. The additional allowance in this regard would be in relation to the expenditure incurred by the assessee by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee. Where the expenditure is incurred after the beginning of commercial production, the special allowance would relate to the expenditure incurred by the assessee, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection [except those assets which qualify for depreciation allowance under Section 32 only in those cases where the agreement is entered into before 31st Day of March, 1981]. Further, expenditure incurred in relation to the depletion of mineral oil in the mining area in respect of assessment year relevant to the accounting year in which commercial production is begun

and such succeeding year as may be specified in the agreement between the Central Government and the assessee would also qualify for this allowance. The amount of this special allowance must be computed in the manner specified in the agreement and wherever necessary the other provisions of the Income-tax Act would, for this purpose, be deemed to have been modified to the extent necessary for giving effect to the terms of the agreement. For the purposes of this section, 'mineral oil', includes petroleum and natural gas.

SPECIAL PROVISIONS CONSEQUENTIAL TO THE CHANGES IN THE RATE OF EXCHANGE OF CURRENCY [Section 43A]

Section 43A of the Income-tax Act contains special provisions to provide for additional allowance to the assessee in respect of capital assets whose actual cost is affected by the changes in the rate of exchange of currency. These provisions are to be taken into account in all cases where an assessee has acquired any depreciable asset from any country outside India for the purposes of his business or profession and as a result of a change in the rate of exchange at any time subsequent to the date of its acquisition by the assessee, there is an increase or reduction in the liability of the assessee in terms of Indian Rupees for making payment towards the whole or part of the cost of the asset or for payment of the whole or part of the moneys borrowed by him from any person directly or indirectly in any foreign currency specifically for the purpose of acquiring the capital asset. The amount by which the liability of the assessee in terms of Indian Rupees is increased or reduced as a result of change in the rate of exchange of the currency, would be added to or as the case may be deducted from the actual cost of the asset as defined in Section 43(1). Consequently, the amounts of depreciation allowable to assessee in respect of the asset would correspondingly be increased or reduced, as the case may be. This provision for changes in the rate of exchange of currency resulting in the increase or reduction in the deduction allowable in respect of actual cost of the asset would apply in respect of capital expenditure on scientific research, capital expenditure incurred for acquisition of patents and copyrights, capital expenditure incurred by companies for promoting family planning amongst their employees and capital expenditure incurred for acquiring a capital asset, the cost of which under Section 48 has to be ascertained for the purpose of determining the amount of capital gains. The assessee would not, however, be entitled to any increase or reduction in the amount of development rebate allowed or allowable to him on the basis of the revised actual cost of the asset.

For these purposes, the expression 'rate of exchange' must be taken to mean the rate of exchange determined or recognised by the Central Government for the conversion of Indian Rupee into foreign currency or vice-versa. In cases where the whole or part of the liability in respect of the payment for the cost of the asset or in respect of the money borrowed from a foreign source for acquiring the capital asset is met not by the assessee but directly or indirectly by any other person or authority, the liability so met by the other persons should not be taken into account for

the purposes of any adjustment in the actual cost of the asset and consequently the depreciation allowable to the assessee arising from the change in the rate of exchange of the currency. If, at the time of change in the rate of exchange arising on account of devaluation or otherwise the actual cost of the asset has been fully paid by the assessee and no money remains outstanding in respect of any sum borrowed specifically for the purpose, no adjustment would be permissible to the assessee. The special provision would, however, apply only in respect of capital expenditure or the value of the capital asset and would not in any way affect the value of the current assets, such as stock-in-trade or other trading assets.

SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION OF CERTAIN ASSETS (SECTION 43C)

Where an asset [other than those referred to in Section 45(2)] which becomes the property of an amalgamated company under a scheme of amalgamation, is sold after February 29, 1988 as stock in trade the cost of acquisition of the asset to the amalgamated company shall be the cost of acquisition of the asset to the amalgamating company as increased by the cost, if any, of any improvement made thereto and the expenditure if any, incurred wholly and exclusively in connection with such transfer.

Where an asset [other than those referred to in Section 45(2)] which becomes the property of the assessee on the total or partial partition of a HUF or under a gift or will or an irrevocable trust is sold after February 29, 1988, as stock in trade, then, in computing the profits and gains from sale of such assets, the cost of acquisition of the said asset to the assessee shall be the cost of acquisition of the said asset to the transferor or the donor, as the case may be, as increased by the cost, if any, incurred wholly and exclusively in connection with such transfer, including the payment of gift-tax, if any, incurred by the transferor or the donor, as the case may be.

COMPUTATION OF INCOME UNDER THE HEAD "PROFITS AND GAINS OF BUSINESS OR PROFESSION" FOR TRANSFER OF IMMOVABLE PROPERTY IN CERTAIN CASES (SECTION 43CA)

Currently, when a capital asset, being immovable property, is transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, then such value (stamp duty value) is taken as full value of consideration under section 50C of the Income-tax Act. These provisions do not apply to transfer of immovable property, held

by the transferor as stock-in-trade. This section has been inserted with effect from assessment year 2014-15 where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable by any authority of state government for the purpose of payment of stamp duty in respect of such transfer the value so adopted or assessed or assessable shall for the purpose of computing income under

the head “Profits and gains of business of profession” shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

Where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of
registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the
agreement for transfer and not as on the date of registration for such transfer.

However, this exception shall apply only in those cases where amount of consideration or a part thereof for the
transfer has been received by any mode other than cash on or before the date of the agreement.

SPECIAL PROVISION IN CASE OF INCOME OF PUBLIC FINANCIAL INSTITUTIONS, ETC. (SECTION 43D)

Section 43D has been inserted by Finance (No. 2) Act, 1991 w.e.f. 1.4.1991. This section provides that in the case of a public financial institution or a scheduled bank or a state financial corporation or a state industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts shall be chargeable to tax in the previous year in which it is credited to profit and loss account by such institution referred above for that year or in the previous year in which it is actually received by them whichever is earlier. With a view to improve the viability of leasing finance companies, the section has been amended to provide that in case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debt shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous year in which it is actually received by it, whichever is earlier.

INSURANCE BUSINESS (SECTION 44)

The profits and gains of any business of insurance must, according to Section 44, be computed in accordance with the rules contained in the First Schedule to the Income-tax Act. For the purpose of the computation, it is immaterial whether the insurance business is carried on by mutual insurance company or by a co-operative society or by any other person. The rules contained in the Schedule would apply notwithstanding anything to the contrary contained in the provisions of the Income-tax Act relating to the computation of income chargeable under the head ‘Interest on Securities’, ‘income from house property’, ‘capital gains’, or ‘income from other sources’ or under the head ‘income from business or profession’.

SPECIAL PROVISIONS FOR DEDUCTION IN CASE OF TRADE, PROFESSIONAL OR SIMILAR ASSOCIATIONS (SECTION 44A)

Section 44A of the Income-tax Act provides for a special deduction in the case of any trade, professional or similar association which is not exempt from Income-tax under Section 10(23A). This deduction is allowable in cases where the amount received during the accounting year by the trade, professional or other associations from its members, whether by way of subscription or otherwise, falls short of the expenditure actually incurred by such association during that accounting year solely for the purpose of protection or advancement of the common interest of the members. Moneys received by way of remuneration for running any specific services to the members would not, however, be treated as forming part of income of the association for this purpose. Consequently, in calculating the amount of deficiency, these receipts would be taken into account and would be allowed as deduction so as to reduce the amount of deficiency. Similarly, capital expenditure and also expenditure deductible in computing the income of the assessee under any other provision of the Act, would not be taken into account in determining the amount of deficiency. The amount of deficiency would be allowable as a deduction in computing the income of the association assessable for the relevant assessment year under the head 'profits and gains from business or profession'. If there is no income assessable under this head or the amount of deficiency allowable to the assessee exceeds the income under this head, the whole or the balance of the amount of deficiency, as the case may be, shall be allowed as a deduction in computing the income of the association assessable for that assessment year under any other head. The amount of deficiency shall not, however, be allowed to be carried forward for any subsequent year.

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.

COMPULSORY AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION (SECTION 44AB)

Section 44AB makes it obligatory for
1. a person to get his accounts audited before the 'specified date' by an 'accountant' if the total sales, turnover or gross receipts in business for the previous year exceed or exceeds `1 crore or 2. a person carrying on profession will also have to get his accounts audited before the specified date, if his gross receipts in profession for a previous year or years relevant to any of the aforesaid assessment years exceed `25 lakhs.
The provision also casts an obligation on such persons to furnish by the 'specified date' a report of the audit in the prescribed form duly signed and verified by the accountant setting forth such particulars as may be prescribed by rules made in this behalf by the Central Board of Direct Taxes. In cases where accounts are required to be audited by or under any other law, it will suffice if the accounts are audited under such other law before the specified date and the assessee furnishes by that the said date the report of the audit as required under such other law.
Where profits and gains from business are deemed to be profits and gains under section 44AE or Section 44BB or Section 44BBB as the case may be and assessee has claimed his income to be lower than the profits and gains then such profits and gains shall be deemed to be profits and gains of his business during the previous year or Assessee carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year Under presumptive assessment under sections mentioned above, if assessee claims that his income is lower than that specified under these sections, assessee is required to 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.

However, as amended by the Finance Act, 1992, the provision of this section of compulsory audit shall not apply to those assessees who derive income under Section 44BBA on and from April 1, 1985 or, as the case may be, the date on which the relevant section came into force, whichever is later.

The term 'accountant' will have the same meaning as in the explanation to Sub-section (2) of Section 288 of the

Income-tax Act and the term "Specified date", in relation to the accounts of the assessee of the previous year relevant to an assessment year means the 31st day of October of the assessment year.

According to Section 271B, if any person fails without reasonable cause to get his accounts audited in respect of any previous year or years relevant to an assessment year or to furnish a report of such audit as required under the aforesaid provision, or furnish the said report along with the return of his income, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum equal to 1/2% of total sales, turnover or gross receipts, as the case may be, in the business, or the gross receipts in the profession of such previous year or years, subject to a maximum of ` 1.5 lakh.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESUMPTIVE BASIS (SECTION 44AD)

The provisions of this section shall be applicable on any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE and whose total turnover or gross receipts in the previous year does not exceed an amount of one crore. This section is inserted by Finance Act, 2009 for providing relief to all the small businesses from maintaing the books of accounts and to reduce the compliance and administrative burden. – This section will cover an individual, Hindu undivided family or a partnership firm, other than Limited Liability Partnership firm and who has not claimed deduction under any of the sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA.

– A sum equal to eight per cent of the total turnover or gross receipts of the assessee in the previous year shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession further the assessee have the option to claim a sum higher than eight per cent of the total turnover or gross receipts.

– No deduction shall be allowed to the assessee under sections 30 to 38 however the salary and interest paid to the partners shall be allowed for deduction subject to the conditions and limits specified in section 40(b)

– The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

– where the assessee claims that his profits and gains from the business are lower than the profits and gains on presumptive basis and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under section 44AA and get them audited and furnish a report of such audit as required under section 44AB.

– The provisions of this section, notwithstanding anything contained in the foregoing provisions, shall not apply to –

(i) a person carrying on profession as referred to in sub-section (1) of section 44AA;

(ii) a person earning income in the nature of commission or brokerage; or

(iii) a person carrying on any agency business.

It means that section 44AA and 44AB shall be applicable only if assessee does not opt for presumptive taxation and his total income exceeds the taxable limit.

SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES (SECTION 44AE)

Section 44AE provides for a system for estimating the income of an assessee engaged in the business of plying, hiring or leasing of goods carriages. The scheme is applicable to an assessee who owns not more than ten goods carriages at any time during the previous year and who is engaged in the business of plying, hiring or leasing of such goods carriages. The profits and gains of each goods carriage shall be estimated as under: (i) `5,000 for every month or part of a month in case of a heavy goods vehicle;

(ii) `4,500 for every month or part of a month in case of other goods vehicle.

The assessee may however declare a higher income.

Any deduction allowable under the provisions of Sections 30 to 38 shall, for the purposes of the above income, be deemed to have been already given full effect to and no further deduction under these sections shall be allowed.

Remuneration and interest paid/payable to partners, shall be allowed as deduction from the income computed under this Section. Such deduction shall however be subject to the conditions and limits specified under Section 40(b). The written down value of any asset used for the purpose of the business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment year.

The assessee is neither required to maintain books of accounts under the provisions of Section 44AA, nor required to get his accounts audited under the provisions of Section 44AB in respect of his income from such business. However, for other business (if any) he will have to comply with the Sections 44AA and 44AB. Income from such business as estimated will be aggregated with other incomes of the assessee from other businesses or other heads of income and all deductions under

Sections 80CCC to 80U will be available to the assessee on fulfillment of the requisite conditions of those sections.

If the assessee claims and produces evidence to prove that profits and gains from such business during assessment year 1997-98 or earlier years is lower than the estimate of profits as per this section, the Assessing Officer shall make assessment of such income under Section 143(3) and determine the sum payable by the assessee on the basis of such assessment.

With effect from assessment year 1998-99 the section has been amended to provide that an assesee can claim his income to be lower than the estimate as per this section. However, in that case he will have to keep books of accounts and other documents as per Section 44AA and will have to get his accounts audited irrespective of the turnover under Section 44AB.

SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF SHIPPING BUSINESS IN THE CASE OF NON-RESIDENTS (SECTION 44B)

In the case of a non-resident assessee, engaged in the business of operation of ships, a sum equal to 7-1/2% of the aggregate of the following amounts shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession':

(i) The amount paid or payable (in India or outside) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and (ii) The amount received or deemed to be received in India, by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS IN CONNECTION WITH THE BUSINESS OF EXPLORATION ETC., OF MINERAL OILS (SECTION 44BB)

(1) Notwithstanding anything to the contrary contained in Sections 28 to 41 and Sections 43 and 43A, in the case of an assessee being a non-resident engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils, a sum equal to ten per cent of the aggregate of the amounts specified in Sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

Provided that Section 44BB(1) shall not apply in a case where provisions of Section 42 or Section 44D or section 44DA or Section 115A or Section 293A apply for the purposes of computing profits or gains or any other income referred to in those sections.

(2) The amounts referred to in Sub-section (1) shall be the following, namely:

(i) the amount paid or payable (whether in India or outside) to the assessee or to any person on his behalf on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used or to be used in the prospecting for, or extraction

or production of mineral oil in India; and (ii) the amount received or deemed to be received in India, by or on behalf of the assessee on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used or to be used in the prospecting for, or extraction or production of, mineral oils outside India.

(3) Notwithstanding anything contained in Sub-section (1), an assessee may claim lower profits and gains than the profits and gains specified in that Sub-section, if he keeps and maintains such books of account and other documents as required under Sub-section (2) of Section 44AA and gets his accounts audited and furnishes a report of such audit as required under Section 44AB, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee under Sub-section (3) of Section 143 and determine the sum payable by, or refundable to, the assessee."

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF THE BUSINESS OF OPERATION OF AIRCRAFT IN THE CASE OF NON-RESIDENTS (SECTION 44BBA)

(1) Notwithstanding anything to the contrary contained in Sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to five per cent of the aggregate of the amounts specified in Sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(2) The amounts referred to in Sub-section (1) shall be the following, namely:

(i) the amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(ii) the amount received or deemed to be received in India, by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF FOREIGN COMPANIES ENGAGED IN THE BUSINESS OF CIVIL CONSTRUCTION ETC. IN CERTAIN TURNKEY POWER PROJECTS [SECTION 44BBB]

(1) Where a foreign company is engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government and financed under any international aid programme, ten per cent of the amount paid or payable, whether in or out of India, to the said assessee or any person on his behalf on account of such assignment shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(2) Notwithstanding anything contained in Sub-section (1), an assessee may claim lower profits and gains than the profits and gains specified in that Sub-section, if he keeps and maintains such books of account and other documents as required under Sub-section (2) of Section 44AA and gets his accounts audited and furnishes a report of such audit as required

under Section 44AB, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee under Sub-section (3) of Section 143 and determine the sum payable by, or refundable to, the assessee.

DEDUCTION OF HEAD OFFICE EXPENDITURE IN THE CASE OF NON-RESIDENTS (SECTION 44C)

A non-resident shall be allowed expenditure in the nature of head office expenditure to the extent of least of:

(a) an amount equal to 5% of the adjusted total income; or

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

Where the adjusted total income of the assessee is a loss, the amount shall be computed at the rate of 5% of the average adjusted total income of the assessee. Adjusted total income means, the total income computed under the provisions of this Act but without giving effect to the following:

(i) allowance referred to in this section;

(ii) unabsorbed depreciation [Section 32(2)];

(iii) investment allowance [Section 32A];

(iv) development rebate [Section 33];

(v) development allowance [Section 33A];

(vi) family planning expenses incurred by a company [Section 36(1)(ix)];

(vii) carried forward business loss [Section 72(1)];

(viii) carried forward speculation loss [Section 73(2)];

(ix) carried forward capital loss [Section 74(1) and (3)];

(x) carried forward loss from horse race [Section 74A(3)];

(xi) deductions from gross total income under Chapter VIA [i.e. under Sections 80C to 80U].

'Average adjusted total income' means the average total income of the assessee of the three assessment years immediately preceding the relevant assessment year or for lesser period if the assessee is assessable for that period, as the case may be.

'Head office expenditure' means executive and general administration expenditure incurred by the assessee outside India including expenditure incurred in respect of:

(i) rent, rates, taxes, repairs, insurance of any premises outside India used for the purpose of business or profession;

(ii) salaries, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary paid or allowed to any employee or other persons employed in, or managing the affairs of any office outside India;

(iii) travelling expenses of the person mentioned in (ii); and

(iv) such other matters connected with executive and general administration as may be prescribed.

COMPUTATION OF INCOME BY WAY OF ROYALTY ETC. IN CASE OF FOREIGN COMPANIES (SECTION 44DA)

In case of a foreign company, the deduction admissible in computing the income by way of royalty or fees for technical service received from government or an Indian concern in pursuance of an agreement made by

it with the government or an Indian concern before 1.4.1976 shall not exceed in the aggregate 20% of the gross amount of such royalty or fees as reduced by so much of the gross amount of such royalty as consists of lump sum consideration for the transfer outside India or the imparting of information outside India in respect of any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property. However, no deduction under any of the sections (Sections 28 to 44C)
shall be allowed in computing the income by way of royalty or fees for technical services received from government or an Indian concern in pursuance of an agreement made by the foreign company with the Indian concern after 31.3.1976 but before the 1st day of April, 2003.
No deduction in respect of any expenditure or allowance shall be allowed under any of the said sections (Sections 28 to 44C) in computing income by way of interest received from Government or an Indian concern on moneys borrowed or debt incurred by the Government or the Indian concern in foreign currency. Further the provisions of section 44BB shall not apply in respect of the income referred to in this section.

REVIEW QUESTIONS

1. Distinguish Between Statutory Provident Fund' And 'Public Provident Fund'.
2. Distinguish Between House Rent Allowance And Rent Free Accommodation.
3. Distinguish Between Allowances And Perquisites.
4. What Is The Meaning Of 'Owner Of House Property' Under Section 27 Of The Income-Tax Act, 1961?
5. What Is 'Annual Value' Of House Property? How Is It Computed?
6. In Computing The Income From House Property What Deductions Are Allowed From The Net Annual
7. Value?
8. What Is The Basis Of Computation Of Income From House Property? How Would You Arrive At The Net
9. Annual Value Of A House Occupied By An Assessee For His Own Residence?
10. What is meant by 'block of assets'? Explain.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

UNIT-5 INCOME FROM CAPITAL GAINS

CONTENTS

- Capital Gains
- Capital Asset
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- Distribution of assets by companies in liquidation
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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 reissue

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

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 semiprecious stone,
and whether or not worked or sewn into any wearing apparel and precious or semiprecious stones,
whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;
(iii) **agricultural land in India,** not being land situate (a) within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000, or (b) in any area within the distance, measured aerially, –
(I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten thousand but not exceeding one lakh; or
(II) not being more than six kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than one lakh but not exceeding ten lakh; or
(III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten lakh.
(iv) **6½ per cent Gold Bonds**, 1977 or 7 per cent Gold Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government;
(v) **Special Bearer Bonds** 1991 issued by the Central Government.
(vi) **Gold Deposit Bonds** issued under the Gold Deposit Scheme, 1999 notified by the Central Government. The Supreme Court in the case of Vodafone International Holdings B.V vs. Union of India [2012] 204 Taxman 408 held that influence/persuasion of a parent company over its subsidiary could not be construed as a right in the legal sense.

To supersede this ruling with retrospective effect from 1st April 1962, an Explanation has been inserted to clarify that 'property' includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

The term property appearing in Section 2(14) has not been defined in the Income tax

Act. Even the Transfer of Property Act does not contain any definition of the term. But, the scope of Section 2(14) is very wide. With the exception of the aforementioned assets, all other assets are included in the category of capital asset. "Capital asset" includes movable/immovable asset, tangible/intangible assets, incorporeal rights and choseinaction. It would also include share of a partner in a firm, goodwill of a firm, mining rights, industrial licence acquired by consideration, tenancy right or leasehold right, foreign currency, right to subscribe for shares, the contractual right of a purchaser to obtain title to an immovable property, etc. Some of the judicial rulings in this context are as follows: Property is a term of widest importance and subject to any limitation which the context may require, it signifies every possible interest which a person can hold and enjoy [Ahmed G.H. Arif v. C.W.T. (1970) 76 ITR 471 (SC)]. Even business interest would be brought within the term property [C.I.T. v. Krishna Warrier (1964) 53 ITR 176 (SC)]. Even the business undertaking as a whole would fall within the definition of the term 'property' in Section 2(14) of the Act. [R.C. 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 assesee, whatever be it's 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 198889, 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 199596, cost of tenancy rights, route permits and loom hours would also be deemed to be nil. From Assessment year 200809, the scope of Section 2(14) has been expanded with the introduction of taxability provision with regards to "personal effects being archeological collections".

TRANSFER

The essential requirement for the incidence of tax on capital gains is the transfer of a 'capital asset'. The Supreme court in the case of Vodafone International Holdings B.V vs. Union of India [2012] 204 Taxman 408 gave the following ruling –

(a) the transfer of shares in the foreign holding company does not result in a extinguishment of the foreign company's control of the Indian company.

(b) It does not constitute an extinguishment and transfer of an asset situated in India.

(c) Transfer of foreign holding company shares offshore, cannot result in an extinguishment of the holding companies right of control of the Indian company and the same does not constitute extinguishment and transfer of an asset/management and control of property situated in India.

To supersede this ruling with retrospective effect from 1st April 1962, Explanation 2 to section 2(47) has been inserted which defines transfer as follows:

'Transfer' includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India. The above transactions would be deemed as a transfer notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India. The distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons, is also regarded as transfer liable to capital gains tax. For the purposes of computing capital gain in such cases, the fair market value of the capital asset on the date of such distribution will be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset.

Transactions which do not constitute transfer [Sections 46 and 47]

(i) any distribution of capital assets on the total or partial partition of a Hindu Undivided Family;

(ii) any transfer of a capital asset under a gift or will or an irrevocable trust;

Provided that this clause shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued by the Central Government in this behalf;

(iii) any transfer of a capital asset by a company to its subsidiary company, if–

(a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and

(b) the subsidiary company is an Indian company;

(iv) any transfer of a capital asset by a subsidiary company to the holding company, if –

(a) the whole of the share capital of the subsidiary company is held by the holding company, and

(b) the holding company is an Indian company;

(v) any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company;

(vi) any transfer in a scheme of amalgamation of a capital asset being share or shares held in an Indian Company, by the amalgamating foreign company to the amalgamated foreign company, if –

(a) at least twentyfive 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 199394); (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 Subsection (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 threefourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated provided that the provisions of Sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demerger referred to in this clause.

(vid) any transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if –

(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholders itself is the amalgamated company, and

(b) the amalgamated company is an Indian company;

(viia) any transfer of a capital asset of such foreign currency convertible bonds or Global Depository Receipts as are referred to in Section 115AC(1) held by a non-resident to another non-resident where the transfer is made outside India (applicable from 1.6.1992);

(viii) any transfer of agricultural land in India effected before the first day of March, 1970; (ix) any transfer of a capital asset being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States;

(x) any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company, into shares or debentures of that company. (xi) any transfer made on or before 31.12.1998 by a person not being a company of a capital asset being membership of a recognised stock exchange to a company in exchange for shares allotted by that company to him (transferor).

(xii) any transfer of land by a sick industrial company made at any time beginning with declaration of it being
sick by the BIFR and ending with the previous year in which its net worth wipes out the accumulated losses.

(xiii) where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital asset or intangible asset to the company: Any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of the demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company. Provided that —

(a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company,

(b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital account stood in the books of the firm on the date of succession.

(c) the partners of the firm do not receive any consideration or benefit, directly or indirectly in any form or manner, other than by way of allotment of shares in the company, and

(d) the aggregate of the share holding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continue to be as such for a period of five years from the date of succession.

(e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for corporatisation which is approved by the Securities and Exchange

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 subsection 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 asessable in the hands of the company [Kannan Rice Mills Ltd. v. C.I.T. (1954) 26 ITR 351]. Further analysis of this subsection 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.)].
Subsection (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 subclause (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 subsection, 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.

REVIEW QUESTIONS

1. Distinguish between 'exemption to capital gains under section 54g' and 'exemption to capital gains under section 54ga'.
2. Distinguish between 'longterm capital gain' and 'shortterm capital gain'.

3. Explain with the help of suitable illustration how capital gains are computed under section 45(2) in case of conversion of capital asset into stock in trade.
4. What are 'capital assets'? What items are not included in capital assets?

Notes

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

IMPORTANT NOTES

UNIT-6 INCOME FROM OTHER SOURCES

CONTENTS

- Income Chargeable Under The Head
- 'Income From Other Sources'
- Taxation Of Dividends
- Meaning Of The Term 'Dividend'
- Deductions Allowable In Computing
- Income From Other Sources
- Amounts Not Deductible
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- Income Chargeable Under The Head 'Income From Other Sources'
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- Review Questions
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The incomes which are neither covered under the head salary, house property, business income or capital gains shall be taxable under head Income from other sources. This head of income is a residual head because it covers all other incomes which are uncovered and which are not exempt from tax.

INCOME CHARGEABLE UNDER THE HEAD 'INCOME FROM OTHER SOURCES' Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as "income from other sources". This head is thus a residuary head of income under which income can be computed only after deciding whether the particular item of income is otherwise assessable under any of the first four heads. In addition to the taxation of income not covered by the other heads, Section 56(2) specifically provides certain items of incomes as being chargeable to tax under the head in every case. The following shall be chargeable to Income Tax under the head Income from other sources: – **(a) Dividends [Section 56(2)(i)]**

Dividend income other than divided referred under section 10(34) shall be included under income from other sources.

(b) Keyman Insurance policy
Amount received under a Keyman insurance Policy, including bonus on each Policy, if it is not taxable under any other head of income shall be chargeable under Income from other sources.

(c) Winnings from lotteries [Section 56(2)(ib)]
Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature shall be chargeable to tax under Income from other sources.

Winnings from lotteries, 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]

(d) Contribution to Provident fund
Income of the nature referred to in Section 2(24)(x) (relating to certain contributions to any provident fund or superannuation fund or any fund set up under the provisions of the ESI Act or any other fund for the welfare of such employees received by the assessee from his employees in his capacity as an employer) will be chargeable to income-tax under the head "income from other sources" if such income is not chargeable to income-tax under the head "profits and gains of business or profession". But if the employer deposits such amount on or before due date of deposit applicable for such contribution, he will be allowed a deduction on account of the same. [Section 56(2)(ic)].

(e) Income by way of interest on securities
if the income by way of interest on securities is not chargeable to income-tax under the head 'Profits and gains of business or profession' than such income shall be taxable under Income from other sources.

(f) Income from hiring of machinery etc. [Section 56(2)(ii)]
Income from machinery, plant or furniture belonging to the assessee and let on hire if the income is not chargeable to income-tax under the head "profits and gains of business or profession" shall be taxable under Income from other sources.

(g) Hiring out of building with machinery etc. [Section 56(2)(iii)]:
Where an assessee lets on hire machinery, plant or furniture belonging to him and also building and the letting of the building is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income-tax under the head "Profits and gains of business or profession" shall be taxable under Income from other sources.

(h) Money Gifts:
Where any sum of money, the aggregate value of which exceeds fifty thousand rupees, is received without consideration, by an individual or a

Hindu undivided family, in any previous year from any person or persons **on or after the 1st day of April, 2006 but before 1st day of October, 2009** , the whole of the aggregate value of such sum shall be taxable under the head Income from other sources. [Section 56(2)(vi)]
Provided that this clause shall not apply to any sum of money received
(a) from any relative; or
(b) on the occasion of the marriage of the individual; or
(c) under a will or by way of inheritance; or
(d) in contemplation of death of the payer; or
(e) from any local authority as defined in the Explanation to clause (20) of section 10; or
(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or
(g) from any trust or institution registered under section 12AA.
Explanation: For the purposes of this clause, relative means
(i) spouse of the individual;
(ii) brother or sister of the individual;
(iii) brother or sister of the spouse of the individual;
(iv) brother or sister of either of the parents of the individual;
(v) any lineal ascendant or descendant of the individual;
(vi) any lineal ascendant or descendant of the spouse of the individual;
(vii) spouse of the person referred to in clauses (ii) to (vi).]

(i) Gifts in Cash or in Kind:

Where an individual or a Hindu undivided family receives, in any previous year, from any person or persons on or after the 1st day of October, 2009 [Section 56(2)(vii)] (a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum shall be chargeable to tax under this head.
(b) (i) any immovable property received without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property shall be taxable under income from other sources.
(ii) any immovable property received for a consideration which is less than the stamp duty value of the property by an amount exceeding fifty thousand rupees, the stamp duty value of such property as exceeds such consideration shall be chargeable to tax under income from other sources. Where the date of the agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of the agreement may be taken.
However, this exception shall apply only in a case where the amount of consideration referred to therein, or a part thereof, has been paid by any mode other than cash on or before the date of the agreement for the transfer of such immovable property.
(c) any property, other than immovable property
(i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration.

shall be chargeable to tax under Income from other sources.

Provided that where the stamp duty value of immovable property as referred to in subclause (b) is disputed by the assessee on grounds mentioned in sub-section (2) of section 50C, the Assessing Officer may refer the valuation of such property to a Valuation Officer, and the provisions of section 50C and sub-section (15) of section 155 shall, as far as may be, apply in relation to the stamp duty value of such property for the purpose of sub-clause (b) as they apply for valuation of capital asset under that section: Provided further that this clause shall not apply to any sum of money or any property received

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer or donor, as the case may be; or

(e) from any local authority as defined in the Explanation to clause (20) of section 10; or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or

(g) from any trust or institution registered under section 12AA.

(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.

shall be chargeable to tax under Income from other sources.

However, this clause shall not apply to any such property received by way of a transaction not regarded as transfer under clause (via) or clause (vic) or clause (vicb) or clause (vid) or clause (vii) of section 47.

(k) Share premiums in excess of the fair market value to be treated as income [Section 56(2)(viib)]

Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be taxable

under Income from other sources. However, that this clause shall not apply where the consideration for issue of shares is received:
(i) by a venture capital undertaking from a venture capital company or a venture capital fund; or
(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.
(l) income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be chargeable to tax under Income from other sources. [Section 56(2)(viii)].
Besides the above, **there are some other incomes which are also chargeable under the head 'Income from Other Sources'.** For example:
(1) Any fees or commission received by an employee from a person other than his employer.
(2) Any annuity received under a Will. It does not include an annuity received by an employee from his employer.
(3) All interest other than interest on securities, e.g. interest on bank deposits, interest on loan, etc.
(4) Income of a tenant from sub-letting the whole or a part of the house property.
(5) Remuneration received by a teacher or a lawyer for doing examination work.
(6) Income of Royalty.
(7) Director's fees.
(8) Rent of land not appurtenant to any building.
(9) Agricultural Income from land situated outside India.
(10) Income from markets, ferries and fisheries, etc.
(11) Income from leasehold property.
(12) Remuneration received for writing articles in Journals.
(13) Income from undisclosed sources.
(14) Interest received by an employee on his own contributions to an unrecognised provident fund.
(15) Casual income in excess of ` 5,000, or (` 2,500 in case of winning from horse race, etc.) as the case may be.
(16) Salary of a Member of Parliament, Member of Legislative Assembly or Council.
(17) Interest received on securities of co-operative society.
(18) Family pension received by the widow of an employee of the U.N.O. is exempt. Similarly the family pension of gallantry awardee is exempt.
(19) Amount withdrawn from deposit in National Savings Scheme, 1987 on which deduction under Section 80CCA has been allowed including interest thereon.
(20) Gratuity received by a director who is not an employee of the company.
(21) Director's commission for giving guarantee to bank.
(22) Director's commission for underwriting shares of a new company.
Further, under the provisions of Section 60 to 65 an assessee may be chargeable to tax in respect of income arising to other persons, e.g. spouse or minor children. In such cases, the income in question will be

first computed under the appropriate head after allowing various deductions and includible in the total income of the assessee under the head “income from other sources”. In other words, wherever the assessee is taxable in respect of income of some body else, the income must be charged to tax in the hands of the assessee only under this head even if the income is of a character which would otherwise fall for assessment under any other head of income.

TAXATION OF DIVIDENDS

Section 10(34) exempts dividend as defined in Section 115-O from tax in the hands of recipients thereof. Section 115-O, the main operative provision in the newly introduced Chapter XII-D, however, calls upon a company declaring/distributing dividend to pay 15% plus surcharge plus Education & Secondary and Higher Education Cess by way of tax on distributed profits in addition to what it is liable by way of tax on its income in the normal course. This tax on distribution paid by a company is not available for deduction under any provision of the Act. Dividend for the purpose of Section 115-O and by extension for the purpose of Section 10(33) is the same as defined in Section 2(22) except that clause (e) thereof shall not be treated as dividend for both these purposes In other words the scheme of taxation of dividend can be summarised as under:

(a) Dividends or any other income distributed by UTI or a foreign company, are chargeable to tax under this head.

(b) In respect of dividend under clause (e) of Section 2(22) the status quo continues i.e. the specified persons receiving loans and advances from a closely-held company will continue to pay tax as earlier on these receipts and the company giving such loans and advances will not be liable to tax like it was earlier. It may be pointed out that tax liability under clause (e) of Section 2(22) would be extremely unlikely now that there is no need for the dominant shareholders of closely-held companies to combine dividend with the character of loan or advance to avoid tax liability because dividend is no longer taxable in the hands of shareholders. Against this backdrop, the discussion hereunder may be studied.

Meaning of the term ‘Dividend’ [Section 2(22)]

The term ‘dividend’ is ordinarily used to refer to any distribution made by a company to its shareholders out of its profits in proportion to the number of shares held by the shareholder concerned in the company. Apart from the distribution made by the company, any division of profit between the members who earned the same would also be treated as dividend under the general meaning of expression. For purposes of income-tax, the definition of dividend is given in Section 2(22) of the Income-tax Act. The definition, although not exhaustive and comprehensive, is having the effect of over-riding anything else to the contrary contained in any other law for the time being in force.

The definition given in the Income-tax Act is enumerative and inclusive in nature and does not precisely specify as to what exactly is meant by the term dividend. Consequently, any money received by a shareholder which may not fall within the various items specified in the Income-tax Act may still be considered and taxable as dividend except in cases where a different interpretation or inference could be had in the

circumstances of the case. According to the definition in the Income-tax Act, 'Dividend' includes the following items:

(a) **Any distribution by a company of accumulated profits, whether capitalised or not**, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company; Current profit would be part of accumulated profits but subsidy on Captal Account cannot be treated as accumulated profts. – CIT v. Rajasthan Wires (P) Ltd. (2003) 130 Taxman 93 DP (Mag.).

(b) **Any distribution, by a company to its shareholders, of debentures debenture stock or deposit certificates in any form,** whether with or without interest and any distribution to its preference shareholders of shares **by way of bonus** to the extent to which the company possesses accumulated profits, whether capitalised or not;

(c) **Any distribution made to the shareholders of a company on its liquidation**, to the extent to which such distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not;

(d) **Any distribution to its shareholders by a company on the reduction of its share capital**, to the extent to which the company possesses accumulated profits, whether capitalised or not;

(e) **Any payment made by a company, in which the public are not substantially interested of any sum** whether representing a part of the assets of the company or otherwise made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without right to participate in profits), holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereinafter in this clause referred to as the said concern), or any payment by any such company on behalf of or for the benefit of the shareholder having substantial interest in the company to the extent to which the company possesses accumulated profits.

But, Sub-section (22) to Section 2 specifically excludes the following:

(i) Any distribution made by a company in accordance with (c) or (d) above in respect of any share issued for full cash consideration in cases where the shareholder is not entitled, in the event of liquidation, to participate in the surplus assets of the company;

(ii) Any distribution made in accordance with items (c) and (d) above in so far the distribution is attributable to the capitalised profits of the company representing bonus shares alloted to its equity shareholders after 31.3.1964 and before 1.4.1965;

(iii) Any advance or loan made by a company to its shareholder the said concern, i.e, a HUF firm, an AOP or, BOI or a company in the ordinary course of its business in cases where lending of money is a substantial part of the business of the company;

(iv) Any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend under item (e) above to the extent to which it is so set off;

(v) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of Section 77A of the Companies Act, 1956;

(vi) Any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company). The enumeration given above represents various payments which are notionally or by fiction of law, treated as dividend and which, in the absence of specific provision may not be chargeable to tax as dividend income in the hands of shareholders. The distributions or payments constituting dividend referred to above apply only to payments or distributions made by a company as defined in Section 2(17) of the Income-tax Act. Since the meaning and scope of the term 'dividend' used in the income-tax Act is much wider than what is commonly understood, it covers not only payments as dividends made by a company in accordance with the provisions of company law but also various other payments which may not amount to dividend under company law. In order to be chargeable to tax as dividend, it is not essential that the dividend must be paid only in cash although the provisions of Company Law require that a dividend must always be paid in cash or by cheque. In all cases where a dividend is paid in any form other than cash, say in the form of goods, securities or shares, even of another company, the amount of dividend which is liable to income-tax must be taken to be the market value of the thing received as dividend.

For instance, if 'A' company distributes dividends to its shareholders in the form of shares of its wholly owned subsidiary company 'B' at the face value of ` 100 each while the market value is ` 150 per share, the liability to tax on the part of the company would be on the basis of the market value of the share. For this purpose, it is immaterial if the shares are such that a part of the shares cannot be divided for being utilized towards tax deductible at source. The company's liabiltiy 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.

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.

2. From the contributions received by employer from employees towards P.F./Superannuation/other funds:

3. Income derived from letting [Section 57(ii)]: Where income is derived from letting out of machinery, plant
or furniture on hire and also buildings where the letting of building is inseparable from the letting of such machinery, plant or furniture and the income from such letting is not chargeable to Income-tax under the head "Profits and Gains of Business or profession", the following expenses incurred in respect of those assets:

(a) Current repairs of buildings.

(b) Insurance premium against risk of damage or destruction of the premises.

(c) Repairs and insurance of machinery, plant or furniture.

(d) Depreciation.

Where the expenses referred to at (a) to (d) hereinabove are incurred on property used partly for the business of the assessee, a proportionate deduction shall be allowed.

4. Income in the nature of family pension [Section 57(iia)]: Where a regular monthly amount is payable by an employer to a person belonging to the family of an employee in the event of his death, i.e., 'family pension', a sum equal to 33-1/3% of the income or ` 15,000, whichever is less, is allowable as a deduction. All these expenses will be allowed only when the prescribed particulars are furnished by the assessee.

5. Interest on compensation or enhanced compensation [Section 56(2)(viii)]: a deduction of a sum equal to
50% of such income and no deduction shall be allowed under any other clause of this section.

6. Other deductions [Section 57(iii)]: Any other expenditure (not being in the nature of capital expenditure)
laid out or expended wholly and exclusively for the purpose of making or earning such income. [Smt. Virmati
Ramkrishna v. C.I.T. (1981) 131 ITR 659(Guj)]

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.

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.

The following amounts shall not be deducted in computing income chargeable under the head 'Income from other sources': In the case of any assessee:

(i) Any personal expenses of the assessee.

(ii) Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.

(iii) Any payment which is chargeable under the head "Salaries" if it is payable outside India unless tax has been paid thereon or deducted therefrom at source.

(iv) Any expenditure referred to in Section 40A of Income-tax Act.

A. Exempted Interest [Section 10(4)]

(i) In the case of a non-resident, any income by way of interest on the securities or bonds notified by the Central Government in the Official Gazette, including income by way of premium on the redemption of such bonds. No securities or bonds will be specified by the Central Govt. for this purpose on or after 1.6.2002. (ii) In case of an individual any income by way of interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1973 and the Rules made thereunder. Provided that such individual is a person resident outside India as defined in Section 2(q) of the said Act or is a person who has been permitted by the Reserve Bank of India to maintain such account.

B. Exempted Interest [Section 10(15)]

The interest income from the following securities enumerated specifically at clause 15 of Section 10 of the Income-tax Act is

exempted. Hence, the interest thereon shall not be included in the income of the assessee.

(i) Income by way of interest, premium on redemption or other payment on such securities, bonds, annuity certificates, savings certificates, other certificates issued by the Central Government and deposits as the Central Government may, by notification in the Official Gazette, specify in this behalf, subject to such conditions and limits as may be specified in the said notification.

(ii) In the case of an individual or a Hindu Undivided family, interest on such Capital Investment Bonds as the Central Government may, by notification in the Official Gazette, specify. (No bonds will be notified by the Central Govt. on or before June 1, 2002)

(iia) In the case of an individual or a Hindu Undivided family, interest on the notified Relief Bonds.

(iib) In the case of : (a) a non-resident Indian, being an individual owning the bonds; or (b) a nominee or survivor of the non-resident Indian; or (c) the donee, being an individual, to whom the bonds have been gifted by the non-resident Indian, the interest received thereon shall be exempt if the bonds are purchased by the non-resident Indian, in foreign exchange and the interest and principal received thereon, whether on maturity or otherwise, is not allowed to be taken out of India. The benefit does not cease even if the non-resident Indian subsequently acquires the status of a resident. But, in the event of premature encashment thereof, the benefit shall cease from the previous year in which the encashment is made. (iii) Interest on securities held by the Issue Department of the Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1949.

(iiia) Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country or any deposits made by it, with the approval of the RBI, with any scheduled bank.

(iva) Interest payable by Government or a local authority on moneys borrowed by it before June 1,2001 from or debts owed by it to sources outside India.

(ivb) Interest payable by an industrial undertaking in India on moneys borrowed by it before June 1, 2001 under a loan agreement entered into with such financial institution in a foreign country as may be approved in this behalf by the Central Government by general or special order.

(ivc) Interest payable by an industrial undertaking in India on any moneys borrowed or debt incurred by it before June 1, 2001 in a foreign country in respect of purchase outside India of raw materials or components or capital plant and machinery to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf having regard to terms of the loan or debt and its repayment. Purchase, includes Hire Purchase Agreement or a lease agreement with an option to purchase such plant and machinery.

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) Europeun 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 univeristy 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.

REVIEW QUESTIONS

1. Explain the deductions which are available to an assessee under section 57 while computing taxable income chargeable under the head 'income from other sources'.
2. Discuss the cases in which payment by way of loan/advance to the extent of accumulated profits by a closely held company is treated as dividend under section 2(22)(e).
3. What are the incomes chargeable under the head "Income from other sources"?
4. What deductions are allowed under the head "Income from other sources"?
5. What expenses are not allowed to be deducted under the head "Income from other sources"?

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

UNIT-7 DEDUCTIONS FROM GROSS TOTAL INCOME

CONTENTS

- ❖ Deductions in relation to various investments are covered under sections 80C to Section 80GGC.
- ❖ Deduction in respect of incomes earned from specific source are covered under sections 80HH to 80RRB.
- ❖ Deduction in respect of other incomes under section 80TTA.
- ❖ Deduction in respect of persons with disability is provided under section 80U.
- ❖ Relief and Rebate in respect of Income-tax
- ❖ Share of member of an association of persons or body of individuals in the income of the association or body (Section 86)
- ❖ Income from an association of persons or a body of individuals (Section 86)
- ❖ Relief when salary is paid in arrears or in advance [Section 89]
- ❖ Review Questions
- ❖ Further Readings

The aggregate of income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as "Gross Total Income". Sections 80A to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessees from their gross total income.

INTRODUCTION

The scheme of the Income-tax Act is to provide for various tax exemptions and concessions in three forms, namely –

(i) Incomes which are wholly exempt from tax by virtue of their exclusion from the scope of total income under Sections 10 to 13A;

(ii) Incomes which are 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

DEDUCTION ON LIFE INSURANCE PREMIA, CONTRIBUTION TO PROVIDENT FUND, ETC. (SECTION 80C)

Eligibility: (a) an individual; (b) a Hindu undivided family.
Entitlement: Deduction from the Gross Total Income of an amount equal to the investments made, subject to a
maximum amount of ` One lakh.
Nature of Investments:
(a) Life Insurance policy taken on the life of an individual assessee or spouse and any child of such individual, and any member of the Hindu Undivided Family. But deduction is not allowed where the premium paid on Life Insurance Policy exceeds 10% of the capital sum assured. However, where the policy, issued on or after the 1st day of April, 2013, is for insurance on life of any person, who is –
(a) a person with disability or a person with severe disability as referred to in section 80U, or (b) suffering from disease or ailment as specified in the rules made under section 80DDB deduction for premium shall be allowed only when such amount shall not exceed 15% of the capital sum assured.
"actual capital sum assured" in relation to a life insurance policy shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account--
(i) the value of any premium agreed to be returned; or
(ii) any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person.
(b) Amounts paid to effect or to keep in force a contract for a non-commulative deferred annuity not being an annuity plan referred to in clause (j) below on the life of: (i) in the case of an individual, the individual, spouse or any child of such individual and However, such contract should not contain a provision for exercise of an option by the insured to receive cash payment in lieu of the payment of the annuity.
(c) Deduction from the salary payable by or on behalf of the Government to any individual, in accordance with the conditions of his service, for securing to him a deferred annuity or making provision for his wife or children, to the extent of one-fifth of salary.
(d) Any contribution made by an individual only to any provident fund to which the Provident Funds Act, 1925, applies; a Recognised provident fund; an approved superannuation fund.

(e) Any contribution to (i) any provident fund set-up and notified by the Central Government in the Official Gazette, [public provident fund has been notified for this purpose] or (ii) a ten-year account or a fifteenyear 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].

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.

DEDUCTION IN RESPECT OF INVESTMENT MADE UNDER ANY EQUITY SAVING SCHEME (SECTION 80CCG)

Section 80CCG has been inserted with effect from the assessment year 2013-14. Deduction is allowed if the following conditions are satisfied:
1. The assessee is a resident individual
2. His gross total income does not exceed `12 Lakh
3. He has acquired listed shares or listed units of an equity oriented funds in accordance with a notified scheme
4. The investment is locked in for a period of 3 years from the date of acquisition in accordance with the above scheme.
5. The assessee satisfies any other condition as may be prescribed.

If the above conditions are satisfied, a deduction will be allowed under section 80CCG. The amount of deduction is 50% of the amount invested in equity shares. However, the amount of deduction under this section cannot be more than ` 25,000. The deduction shall be allowed for 3 consecutive assesment years beginning with assessment years in which listed equity shares or units were first acquired.

DEDUCTION IN RESPECT OF MEDICAL INSURANCE PREMIA (SECTION 80D)

(1) In computing the total income of an assessee, being **an individual or a Hindu undivided family**, there shall
be deducted such sum, as specified in sub-section (2) or sub-section (3), payment of which is made by any mode as specified in the previous year out of his income chargeable to tax. (2) Where the assessee is an individual, the sum referred to in sub-section (1) shall be the aggregate of the following:
(a) the whole of the amount paid to effect or to keep in force an insurance on the health of the assessee or his family or "any contribution made to the Central Government Health Scheme" or such other scheme as may be notified by the Central Government in this behalf or any payment made on account of preventive health check-up of the assessee or his family and the sum does not exceed in the aggregate `15000; and
(b) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee or any

payment made on account of preventive health check-up of the assessee or his family as does not exceed in the aggregate `15,000.

The deduction in respect of payment made on account of preventive health check up shall not exceed ` 5,000. Explanation: family means the spouse and dependent children of the assessee. Payment shall be made by any mode, including cash, in respect of any sum paid on account of preventive health check-up and by any mode other than cash in all cases other than preventive health check up. (3) Where the assessee is a Hindu undivided family, the sum referred to in sub-section (1) shall be the whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided family as does not exceed in the aggregate ` 15,000.

(4) In case of a senior citizen the amount shall not exceed ` 20,000.

DEDUCTION IN RESPECT OF MAINTENANCE INCLUDING MEDICAL TREATMENT OF A DEPENDANT WHO IS A PERSON WITH DISABILITY [SECTION 80DD]

(1) Where an assessee, being an individual or a Hindu undivided family, who is a resident in India, has, during
the previous year, –

(a) incurred any expenditure for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability; or

(b) paid or deposited any amount under a scheme framed in this behalf by the Life Insurance Corporation or any other insurer or the Administrator or the specified company subject to the conditions specified in Sub-section (2) and approved by the Board in this behalf for the maintenance of a dependant, being a person with disability,

the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of a sum of rupees fifty thousand rupees from his gross total income in respect of the previous year:

Provided that where such dependant is a person with severe disability, the provisions of this sub-section shall have effect as if for the words "fifty thousand rupees", the words "one hundred thousand rupees" had been substituted.

(2) The deduction under clause (b) of Sub-section (1) shall be allowed only if the following conditions are fulfilled, namely: –

(a) the scheme referred to in clause (b) of Sub-section (1) provides for payment of annuity or lump sum amount for the benefit of a dependant, being a person with disability, in the event of the death of the individual or the member of the Hindu undivided family in whose name subscription to the scheme has been made;

(b) the assessee nominates either the dependant, being a person with disability, or any other person or a trust to receive the payment on his behalf, for the benefit of the dependant, being a person with disability.

(3) If the dependant, being a person with disability, predeceases the individual or the member of the Hindu undivided family referred to in Sub-section (2), an amount equal to the amount paid or deposited under Clause (b) of Subsection

(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 disabilityhad 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
(b) **"dependant"** means –
(i) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them;
(ii) in the case of a Hindu undivided family, a member of the Hindu undivided family, dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance, and who has not claimed any deduction under Section 80U in computing his total income for the assessment
year relating to the previous year;
(c) **"disability"** shall have the meaning assigned to it in clause (i) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
(d) **"Life Insurance Corporation"** shall have the same meaning as in Clause (iii) of Sub-section (8) of Section 88;
(e) **"medical authority"** means the medical authority as referred to in clause (p) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
(f) **"person with disability"** means a person as referred to in Clause (f) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
(g) **"person with severe disability"** means a person with eighty per cent or more of one or more disabilities, as referred to in Sub-section (4) of Section 56 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
(h) **"specified company"** means a company as referred to in Clause (h) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002).

DEDUCTION IN RESPECT OF MEDICAL TREATMENT, ETC. (SECTION 80DDB READ WITH RULE 11DD)

Where an individual or HUF who is resident in India has, during the previous year, actually paid any amount for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board –

(a) for himself or a dependant, in case the assessee is an individual; or

(b) for any member of a Hindu undivided family, in case the assessee is a Hindu undivided family, the assessee shall be allowed a deduction of the amount actually paid or a sum of forty thousand rupees, whichever is less, in respect of that previous year in which such amount was actually paid:

Provided that no such deduction shall be allowed unless the assessee furnishes with the return of income, a certificate in prescribed form (No. 10-I) from a neurologist, an oncologist, a urologist, a haematologist, an immunologist or such other specialist, as may be prescribed, working in a Government hospital: Provided further that the deduction under this section shall be reduced by the amount received, if any, under an insurance from an insurer, or reimbursed by an employer, for the medical treatment of the person referred to in Clause (a) or Clause (b);

Provided also that where the amount actually paid is in respect of the assessee or his dependant or any member of a Hindu undivided family of the assessee and who is a senior citizen, the provisions of this section shall have effect as if for the words "forty thousand rupees", the words "sixty thousand rupees" had been substituted. Explanation. – For the purposes of this section, –

(i) **"dependant"** means –

(a) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them,

(b) in the case of a Hindu undivided family, a member of the Hindu undivided family, dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance;

(ii) **"Government hospital"** includes a departmental dispensary whether full-time or part-time established and run by a Department of the Government for the medical attendance and treatment of a class or classes of Government servants and members of their families, a hospital maintained by a local authority and any other hospital with which arrangements have been made by the Government for the treatment of Government servants;

(iii) **"insurer"** shall have the meaning assigned to it in Clause (9) of Section 2 of the Insurance Act, 1938 (4 of 1938);

(iv) **"senior citizen"** means an individual resident in India who is of the age of sixty years or more at any time during the relevant previous year.

DEDUCTION IN RESPECT OF REPAYMENT OF LOAN TAKEN FOR HIGHER EDUCATION (SECTION 80E)

The deduction of an amount actually paid by an individual during the previous year out of his income chargeable to tax by way of an interest on loan, taken by him from any financial institution or any approved charitable institution for the purpose of pursuing his higher education. The deduction will be available in computing the total income in respect

of initial assessment years and the seven assessment years immediately succeeding the initial assessment year or until the interest thereon is paid by such individual in full, whichever is earlier. The expression **"higher education"** is being defined to mean any course of study pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority to do so. The expression "financial institution" is being defined to mean a banking company to which the "Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in Section 51 of the Act) or any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf. The expression "approved charitable institution" is being defined to mean an institution specified in, or as the case may be, an institution established for charitable purposes and notified by the Central Government under Section 10(23C) or an institution referred to in Section 80G(2)(a). The expression "initial assessment year" means the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan. "Relative", in relation to an individual, means the spouse and children of that individual or the student for whom the individual is the legal guardian.

DEDUCTION IN RESPECT OF INTEREST ON LOAN TAKEN FOR RESIDENTIAL HOUSE PROPERTY (SECTION 80EE)

Interest payable on loan taken by an individual from any financial institution for the purpose of acquisition of a residential house property shall be allowed as deduction under this section on fulfillment of certain conditions [Section 80EE(1)].

Conditions [Section 80EE(3)]

The deduction under section shall be subject to the following conditions, namely

(i) the loan has been sanctioned by the financial institution during the period beginning on the 1st day of April, 2013 and ending on the 31st day of March, 2014;

(ii) the amount of loan sanctioned for acquisition of the residential house property does not exceed 25 lakh rupees;

(iii) the value of the residential house property does not exceed 40 lakh rupees;

(iv) the assessee does not own any residential house property on the date of sanction of the loan.

Amount of Deduction: The deduction shall not exceed 1 lakh rupees and shall be allowed in computing the total income of the individual for the assessment year 2014-15 and in a case where the interest payable for the previous year relevant to the said assessment year is less than 1 lakh rupees, the balance amount shall be allowed in the assessment year 2015-16 [Section 80EE(2)].

Where a deduction under this section is allowed for any interest, deduction shall not be allowed in respect of such interest under any other provisions of the Act for the same or any other assessment year.

(a) "financial institution" means a banking company to which the Banking Regulation Act, 1949 (10 of 1949) applies including any bank or banking institution referred to in section 51 of that Act or a housing finance company;
(b) "housing finance company" means a public company formed or registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

DEDUCTION IN RESPECT OF DONATIONS TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC. (SECTION 80G)

Deduction under this section is allowed to all type of assessees. Further, Sub-section (5A) of Section 80Gclarifies that is a case where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not again qualify for deduction under any other provision of the Act for the same or any other assessment year:

Quantum of deduction:

(A) 100% Deduction without any qualifying limit:

(i) National Defense fund.
(ii) Prime Minister's National relief fund.
(iii) Prime Minister's Earthquake relief fund.
(iv) Africa fund.
(v) National Trust for welfare of persons with autism, cerebral palsy, mental retardation and multiple disabilities.
(vi) National cultural fund set up by the Central Government.
(vii) The Chief Minister's relief fund or the lieutenant Governor's relief fund.
(viii) National Illness Assistance fund.
(ix) The Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996.
(x) The Army/Air force Central welfare fund or the Indian Naval Benevolent fund.
(xi) Any fund set up by a State Government to provide medical relief to poors.
(xii) The National/State Blood transfusion Council.
(xiii) Zila Saksharta Samiti constituted in any district.
(xiv) Any fund set up by the State Government of Gujarat, exclusively for providing relief to the victims of
earthquake in Gujarat.
(xv) Maharashtra Chief Minister's Earthquake Relief Fund.
(xvi) University/Educational Institute of National Eminence approved by the prescribed authority.
(xvii) National foundation for communal harmony.
(xviii) Fund for technology development and application, set up by the Central Government.
(xix) National sports fund set up by the Central Government.
(xx) National Children's Fund.

(B) 50% Deduction without any qualifying limit:

(i) Jawaharlal Nehru Memorial Fund.
(ii) Indira Gandhi Memorial Trust.
(iii) Rajiv Gandhi Foundation.

(iv) Prime Minister's Drought Relief Fund.

(C) 100% Deduction subject to qualifying limit:

(i) Any sum to Government or any approved local authority, institution or association to be utilized for promoting family planning.

(ii) Any sum paid by the assessee, being a company, in the previous year as donation to Indian Olympic Association or to any other association established in India and notified by the Central Government for:

I. Development of infrastructure for sports and games or

II. Sponsorship of sports and games in India.

(D) 50% Deduction subject to qualifying limit:

(i) Donation to Government or any approved Local Authority, Institution or Association to be utilized for any Charitable purpose other than promoting family planning.

(ii) Any other Fund or Institution, which satisfies the conditions of Section 80G(5).

(iii) Notified Temple, Mosque, Gurudwara, Church or any other place notified by the Central Government to be of historic, as chorological or artistic importance, for renovation or repair of such place.

(iv) Any corporation established by the Central or State Government specified under Section 10(26BB) for
promoting interests of the members of a minority community.

(v) Any authority constituted in India by or under any law for satisfying the need for housing accommodation or for the purpose of planning development or improvement of cities, towns and villages or for both for applying qualifying limit, all donations made to funds/institutions covered under (C) and (D) above shall be aggregated and the aggregate amount shall be limited to 10% of adjusted Gross Total Income :

– Adjusted Gross total income means the "Gross Total Income" as reduced by:

I. Long-term Capital gains, if any which have been included in the "Gross Total Income".

II. All deductions permissible under Sections 80C to 80U excepting deduction under Section 80G.

III. Exempted Income.

IV. Income of NRIs and Foreign Companies under Sections 115A, 115AB, 115AC, 115ACA or 115AD.

– Quantum of deduction: Aggregate of deduction permissible under clauses (A), (B), (C) & (D).

No deduction shall be allowed under this section in respect of donation of any sum exceeding ten thousand
rupees unless such sum is paid by any mode other than cash.

DEDUCTION IN RESPECT OF RENT PAID (SECTION 80GG)

Deductions admissible under this Section is:

– Actual rent paid less 10% of 'Adjusted Total Income'.

– 25% of such 'Adjusted Total Income'.

– Amount calculated at ` 2,000 p.m.

whichever is least.

Adjusted Total Income means the Gross total income as reduced by long term capital gain if included in the gross total income and income referred to in section 115A to 115D and the amount of deduction under

section 80C other than deduction under this section. However, certain conditions as given below are required to be fulfilled/satisfied for claiming deduction u/s 80GG

– The assessee should not be receiving any house rent allowance exempt u/s 10(13A) or rent free accommodation.

– The accommodation should be occupied by the assessee for the purpose of his own residence.

– The assessee fulfills such other conditions or limitations as may be prescribed having regard to the area or place in which such accommodation is situated and other relevant consideration.

– The assessee or his spouse or his minor child or an HUF of which he is a member does not own any accommodation at the place where he ordinarily resides or performs duties of his office or employment or carries on his business or profession.

– If the assessee owns any accommodation at any place other than that referred to above, such accommodation should not be in the occupation of the assessee and its annual value is not required to be determined under Section 23(2)(a)(i) or Section 23(2)(b).

– Allowed only to an individual assessee after furnishing Form 10BA along with return of income.

DEDUCTION IN RESPECT OF CERTAIN DONATIONS FOR SCIENTIFIC RESEARCH OR RURAL DEVELOPMENT (SECTION 80GGA)

An assessee (other than an assessee whose gross total income includes income chargeable under the head "profits and gains of business or profession") is entitled to 100% deduction in the computation of his total incomein 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 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.

DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY COMPANIES TO POLITICAL PARTIES OR AN ELECTORAL TRUST(SECTION 80GGB)

Any sum contributed by an Indian Company in the previous year to any political party or to an electoral trust shall be allowed as deduction while computing its total income.

Note : Sum contributed by way of cash shall not be allowed as deduction.

DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY ANY PERSON TO POLITICAL PARTIES OR AN ELECTORAL TRUST (SECTION 80GGC)

Any amount of contribution made by an assessee being any person to a political party or an electoral trust except local authority and every artificial juridical person wholly or partly funded by the Government shall be allowed as deduction while computing the total income of such person. Note : Sum contributed by way of cash shall not be allowed as deduction.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM INDUSTRIAL UNDERTAKINGS OR ENTERPRISE ENGAGED IN INFRASTRUCTURE DEVELOPMENT (SECTION 80-IA)

A deduction will be allowed from gross total income to an assessee in respect of profits and gains derived from
any business of:

(1) Infrastructure facility: The enterprise is carrying on the business of operating any infrastructure facility which fulfills the following conditions:
(a) It is owned by an Indian company or consortium of companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act registered in India;
(b) It enters into an agreement with the Central or State Government or a local authority or any other statutory body for (i) developing, (ii) operating and maintaining, (iii) developing, operating and maintaining, a new infrastructure facility.
(c) It 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.
The benefit of deduction to housing and other development activities which are an internal part of a highway project shall be allowed if the following conditions are satisfied:
(a) Such profits are transferred to a special reserve account.
(b) Such profits are utilised for highway project, excluding housing and other activities, before the expiry of three years following the year in which the amount was transferred to the reserve account.
The amount remaining unutilised shall be chargeable to tax as income of the year in which it was transferred to the reserve account.
(2) Telecommunication services: Any undertaking which has started or starts providing telecommunication services whether basic or cellular including radio-paging, domestic satellite service or network of trunking and electronic data interchange services at any time after 31.3.1995 but before 31.3.2005. Domestic Satellite Service means a satellite owned and operated by an Indian Company for providing telecommunication services.
(3) Industrial park: Any undertaking which develops a special economic zone and operates an industrial park (notified by the Central Government) after 31.3.1997 but before 1.4.2006 and in case of SEZ, it should begin on or after 1.4.2001 but before 1.4.2006.Where an undertaking develops industrial park after 31.3.1999 and transfers the operations and maintenance of it to another undertaking, the transferee will get the benefit of deduction for the unexpired period. However, Investments made to develop industrial park has been extended from 31.3.2006 to 31.3.2011.
(4) Generation and distribution of power: An undertaking which:
(a) is set-up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the

period beginning on the 1st day of April, 1993 and ending on the 31st day of March 2014.

(b) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period beginning on the 1st day of April, 1999 and ending on the 31st day of March 2014.

(c) undertakes substantial renovation and modernization of the existing network of transmission or distribution lines at any time during the period beginning on the 1st day of April, 2004 and ending on the 31st day of March, 2014.

Provided that the deduction under this section to an industrial undertaking under sub-clause (b) shall be allowed only in relation to the profits derived from laying of such network of new lines for transmission or distribution. **Quantum and period of deduction:**

(1) First five assessment years - 100% of such profits.

(2) Next five assessment years - In case of companies 30% of such profits. In case of other 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 prmfits and gains of such eligible business shall be recomputed as if transfer has been made at the market value of such goods, as on that date.

If in the opinion of the Assessing Officer, such recomputation presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit. Market Value in relation to any goods or services, means

(i) the price that such goods or services would ordinarily fetch in the open market; or

(ii) the arm's length price as defined in clause (ii) of section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

Where deduction to an industrial undertaking or an enterprise for profit and gains is allowed under this section for any assessment year, deduction to that extent shall not be allowed under any other provision of chapter VIA under the heading deductions in respect of certain incomes.

The deduction shall not exceed the profit and gains of such eligible business of industrial undertaking or enterprise. If the profit shown for the eligible business under this section, appears to the assessing officer as more than the ordinary profits which might be expected to arise in such eligible business, owing to some close connection with a person with whom business transactions are so arranged to yield higher profit, the assessing officer may take the amount of profits as may be reasonably derived there from. 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 sectionfor 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 amalgamatedor resulting company as they would have applied to the amalgamating or demerged company as if the amalgamation or demerger had not taken place.

REVIEW QUESTIONS

1. Enumerate the various deductions allowable to individuals from their total income in respect of their incomes and payments.
2. Enumerate the various rebates and reliefs available to individuals under the Income-tax Act, 1961.
3. What are the different kinds of incomes which are included in the total income but on which no incometax is payable?
4. What conditions are to be satisfied in order to claim a deduction for donations made to certain funds or/ and charitable institutions? Illustrate.

5. Write a short note on the relief available under Section 89.
6. Explain in brief the deduction for the medical insurance premium paid by the assessee.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

IMPORTANT NOTES

UNIT-8 COMPUTATION OF TAX LIABILITY OF FIRM

CONTENTS

- Taxation of Firms
- Taxation of Association Of Persons
- Taxation of Co-Operative Societies
- Tonnage Tax Scheme
- Review Questions
- Further Readings

TAXATION OF FIRMS

Under Section 2(23) of the Income-tax Act, the terms "firm", "partner", and "partnership" have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008. The expression "partner" also includes a minor who has been admitted to the benefits of partnership and a partner of a Limited Liability Partnership Act 2008. However a minor cannot validly enter into any partnership as a 'full partner' with other persons but he can be admitted to the benefits of partnership only. A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

A partnership firm as such is not entitled to enter into a partnership with another firm, H.U.F., individual, or a company. However, its partners in their individual capacity can enter into another partnership.

(1) Scheme of taxation of a firm and its partners

Assessment as a Firm (Section 184)

As per the scheme, a partnership firm in the first assessment year shall be assessed as a firm if the following conditions are satisfied:

1. The partnership is evidenced by an instrument i.e. partnership deed.
2. The individual shares of the partners are specified in that instrument.
3. A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought. Where the return is made after the dissolution of the firm, the copy of the partnership deed should be certified in writing by all persons (excluding minors) who were partners of the firm immediately before its dissolution and by the legal representative of any deceased partner.

When a **firm is assessed as such for any assessment year**, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or in the shares of partners as

evidenced by the partnership deed on the basis of which assessment as a firm was first sought. Where any such change has taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year. In doing so all the provisions of Section 184 will apply to the firm.

Circumstances where the firm will be assessed as a firm but shall not be eligible for deduction on account of
interest, salary, bonus, etc. Where the firm –

(a) fails to make the return required under Section 139(1) and has not made a return or revised return under Section 139(4) or 139(5), or (b) fails to comply with all the terms of a notice issued under Section 142(1) or fails to comply with a direction issued under Section 142(2A), or

(c) having made a return, fails to comply with all the terms of a notice issued under Section 143(2),

(d) does not comply with three conditions mentioned above u/s 184. then the firm shall not be eligible for any deduction on account of interest to a partner and remuneration to a working partner although the same is mentioned in the partnership deed.

Rate of tax In the case of a firm which is assessable as such (i.e. as a firm), tax is chargeable on its total income at the rate of 30% Surcharge @10% shall be applicable where the total income exceeds ` 1 crore. Partnership is not a separate entity distinct from the partners, but for tax purposes a partnership is taxed as a separate entity and therefore total income will be computed under various heads of income. A partnership firm is also entitled for deductions under section 30 to 37 for expenditures incurred. However, for payment of remuneration to partners and interest on capital are allowed subject to conditions laid down under section 40(b).

Section 40(b), contain the following conditions which need to be complied with while making payment of remuneration and interest on borrowed capital to the partners:

(i) Payment of salary, bonus, commission or remuneration by whatever name called to a non-working partner shall not be allowed as deduction. Such payments are allowed only to working partners if it is authorised by and is in accordance with partnership deed.

(ii) Interest payable to a partner, although authorised by the partnership deed shall be allowable as deduction subject to a maximum of 12% p.a. If the partnership deed provides for interest at less than 12% p.a, the deduction of interest shall be allowed to the extent provided by the partnership deed.

(iii) the payment of remuneration to working partner, although authorised by partnership deed however it is subject to maximum of the following limits. Finance Act, 2009 provides for uniform limits for both professional firms and non professional firms: I. On the first Rs. 3,00,000 of the book-profit Rs. 1,50,000 or 90% of the book-profit, whichever or in case of a loss is more.

II. On the balance of the book-profit 60% of the book profits.

Meaning of Book Profit [Explanation 3 to section 40(b)]

Book-profit" means the net profit, as shown in the profit and loss account and make the additions and deductions as per section 28 to 44D explained under the head income from Business and Profession increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit. Interest paid/payable to partners in excess of 12% shall also be disallowed as per section 40(b).

(2) Change in Constitution of a Firm (Section 187)

Where at the time of making an assessment under Section 143 or Section 144 of the Act it is found that a change has occurred in the constitution of a firm, the assessment will be made on the firm as constituted at the time of making the assessment. For the purposes of this section there is a change in the constitution of a firm if:

(a) one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (this clause, however, shall not apply to a case where the firm is dissolved on the death of any of its partners) or (b) where all the partners continue with a change in their respective shares or in the shares of some of them.

(3) Losses of Registered Firms (Section 75)

Carry forward and set off of losses in case of change in constitution of firm or on succession [Section 78(1)]

Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

Method of computation of amount not to be allowed to be carried forward

Step 1: In the year of change first ascertain the share of outgoing partner in the profit or loss of the firm. Step 2: Compute share of loss of the outgoing partner for each of the preceding years from which the loss is carried forward.

Step 3: Amount not allowed to be carried forward:

(i) Sum of [Amounts computed in Steps (1) and (2) where there is loss in the year of change].

(ii) Difference of [Amounts computed in Steps (1) and (2) in case of profit in the year of change].

(4) Assessment of Partners

As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm **will not be included in computing his total income**. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.

Further, the explanation to Sub-clause (2A) provides that the share of a partner in the total income of the firm assessed as a firm shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm (in accordance with

the partnership deed) bears to such profits. In terms of a formula, the **amount exempt** would be:
Partners share in the profit of the firm =Total income of the firm Total Profits of the Firm as shown in thepartnership deed
Any interest, salary, bonus, commission or remuneration by whatever name called which is due to or received by a partner of a firm from the firm will be chargeable to tax in the hands of the partner under the head "profits and gains of business or profession". However, if such salary, interest, bonus, commission or remuneration (or any part thereof) has not been allowed as deduction as per Section 40(b) in the hands of the firm, the amount not allowed as deduction shall not be charged to tax in the hands of partners.
Further, deductions under Sections 32 to 37 can be claimed by a partner from any income where any expenditure was incurred to earn such income.

(5) Succession of one firm by another firm (Section 188)

When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm (62 I.T.R. 75).
In CIT v. K.H. Chambers (1965) 55 ITR 674, the Supreme Court laid down the following requisites of succession:
(i) There is a change of ownership.
(ii) The whole business is transferred.
(iii) Substantially the identity and the continuity of the business are preserved.
Where the partnership deed does not provide specifically for continuance of the firm on the death of a partner,
there would be no change in constitution of the firm but it would be a case of succession. [Addl. CIT v. Thyagasundara Mudaliar (1981) 127 ITR 520].
Where a firm is succeeded by another firm, separate assessments are made on the predecessor and successor firms respectively in accordance with the provisions of Section 170 which provides that the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession and the successor shall be assessed in respect of the income of the previous year after the date of succession. If the predecessor cannot be found, or the tax assessed on the predecessor cannot be recovered from him for the previous year (in which the succession took place) and the previous year immediately preceding such previous year, the unrealised tax payable by the predecessor shall be recovered from the successor.
However, the successor firm is entitled to recover from the predecessor firm any tax paid by it on behalf of the former. If any tax is due against any partner of the predecessor firm, it cannot be recovered from the successor firm.

Joint and several liability of partners for tax payable by firm (Section 188A)

As per this section every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of Income-tax Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Firm Dissolved or Business Discontinued (Section 189)

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provisions relating to penalty or any other sum (interest, fine) chargeable under the Act, shall apply. Consequently, every person who was a partner of the firm at the time of discontinuance of business or dissolution of the firm and legal representative of the deceased partner shall be jointly and severally liable to the amount of tax penalty and any other sum. Where the dissolution or discontinuance of business takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the partners or legal representative of a deceased partner from the stage at which the proceedings stood at the time of such dissolution or discontinuance.

Thus, every partner of the firm and the legal representative of the deceased partner is liable to pay the tax which is already due or may have become due after the dissolution, irrespective of his interest in the firm. However, if there was any irrecoverable amount at the time of dissolution or discontinuance of business and later on it was recovered by the partners, the partners shall personally pay the tax on their share so recovered.

(6) Computation of income on estimated basis in case, taxpayers are engaged in certain business (Section 44AD)

An assessee being an individual, a resident HUF or a partnership firm (not being a LLP), who has not claimed any deduction under Sections 10A, 10AA, 10B, 10BA, 80HH to 80 RRB in the relevant assessment year is eligible to pay tax on estimated basis. Further, the assessee should be engaged in any business (whether it is retail trading or wholesale trading or civil construction or any other business). The turnover/gross receipt of the eligible business shoud not exceed `1 crore during the previous year.

The following persons are not eligible to avail benefit under Section 44AD:

(a) a person carrying on profession as referred to in Section 44AA(1) or

(b) a person earning income in the nature of commission or brokerage or

(c) a prson carrying on any agency business or

(d) a person who is in the business of plying, hiring or leasing goods carriages.

If the above conditions are satisfied, the income from eligible business is estimated @ 8% of gross receipt or total turnover. Further, it is assumed that all the deductions have been allowed and no other deduction is allowed. However, in case of firm, the normal deduction in respect of salary and interest to partners under Section 40(b) shall be allowed.

Other Provisions relating to Limited Liability Partnership:

(1) Transfer of capital asset or intangible asset by a private Limited company or a non-listed company to Limited Liability Partnership and correspondingly any transfer of a share or shares held in a company by a shareholder shall not be treated as transfer:

Any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership in accordance with the provisions of section 56 or section 57 of the Limited Liability Partnership Act, 2008 shall not treated as transfer for the purpose of capital gain under section 45 subject to the following conditions:

(a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;

(b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;

(c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;

(d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;

(e) the total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees; and

(f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

(2) Consequential amendments due to conversion of a private limited company or a non-listed company into LLP:

(i) Allowability of depreciation: Aggregate deduction, in respect of depreciation of buildings, machinery, plant or furniture, being tangible assets or know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets allowable to the predecessor and the successor in the

case of succession of company into LLP, shall not exceed in any previous year the deduction calculated at the prescribed rates as if the succession, had not taken place.

(ii) Successor LLP will be allowed deduction of payment under Voluntary Retirement Scheme for the unexpired period: Where a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, the provisions of this section shall, as far as may be, apply to the successor limited liability partnership, as they would have applied to the said company, if reorganisation of business had not taken place.]

(iii) Cost of Acquisition of the asset in case the predecessor company has claimed deduction under section 35AD shall be taken to be nil in the hands of LLP.

(iv) Actual cost of the block of the asset in the hand of successor LLP:

Where in any previous year, any block of assets is transferred by a private company or unlisted public company to a limited liability partnership and the conditions specified in the proviso to clause (xiiib) of section 47 are satisfied, then, notwithstanding anything contained in clause (1), the actual cost of the block of assets in the case of the limited liability partnership shall be the written down value of the block of assets as in the case of the said company on the date of conversion of the company into the limited liability partnership.

(v) Carry Forward and set off of losses (Section 72A(6A):

Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

However, if any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

"Accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set

off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

"Unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

(vi) MAT credit of the predecessor company will lapse.

(7) Alternate Minimum Tax (AMT) (Section 115JC)

Where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall deemed to be the total income of that person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%. Upto Assessment Year 2012-13, Alternate Minimum Tax (AMT) is levied on limited liability partnerships (LLPs). However, no such tax is levied on the other form of business organisations such as partnership firms, sole proprietorship, association of persons, etc.

In order to widen the tax base vis-à-vis profit linked deductions, the provisions regarding AMT has been broaden to cover all persons other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" or under section 10AA, shall be liable to pay AMT.

Accordingly, where the regular income-tax payable for a previous year by a person (other than a company) is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of such person and he shall be liable to pay income-tax on such total income at the rate of **eighteen and one-half per cent**.

For the purpose of the above,

(i) "adjusted total income" shall be the total income before giving effect to provisions of Chapter XII-BA as increased by the deductions claimed under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" and deduction claimed under section 10AA;

(ii) "alternate minimum tax:" shall be the amount of tax computed on adjusted total income at a rate of eighteen and one half per cent; and

(iii) "regular income-tax" shall be the income-tax payable for a previous year by a person other than a company on his total income in accordance with the provisions of the Act other than the provisions of Chapter XII-BA.

It is further provided that the provisions of AMT under Chapter XII-BA shall not apply to an individual or a Hindu undivided family or an

association of persons or a body of individuals (whether incorporated or not) or an
artificial juridical person referred to in section 2(31)(vii) if the adjusted total income of such person **does not exceed twenty lakh rupees.**

It is also provided that the credit for tax (tax credit) paid by a person on account of AMT under Chapter XIIBA shall be allowed to the extent of the excess of the AMT paid over the regular income-tax. This tax credit shall be allowed to be carried forward up to the tenth assessment year immediately succeeding the assessment year for which such credit becomes allowable. It shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the AMT to the extent of the excess of the regular income-tax over the AMT.

Every person to which this section applies shall obtain a report, in such form as may be prescribed from an accountant certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under sub-section (1) of section 139.

REVIEW QUESTIONS

1. What is the New Scheme of Taxation of a firm?
2. Explain in brief the condition for allowability of deduction of interest to a partner.
3. Explain the difference between the change in constitution and succession of a firm. Illustrate.
4. What is meant by Association of Persons? How is it formed?
5. Discuss tax liability of an Association of Persons.
6. Discuss tax liability of the members of Association of Persons. State the circumstances, if any, under which
7. their share of income from an association of persons is not chargeable to tax.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

IMPORTANT NOTES

UNIT-9 COMPUTATION OF TAX LIABILITY OF COMPANIES

CONTENTS

- Constitutional Provisions
- Meaning of Company Under Section 2(17) of The Income-Tax Act
- Categories of Companies Under The Income tax Act, 1961
- Tax Incidence Under Income-Tax Act, 1961
- Rates of Income Tax For Assessment Year 2014-15
- Minimum Alternate Tax (Mat)
- Dividend Distribution Tax U/S 115-O Taxation of Foreign Dividends (Section 115bbd)
- Review Questions
- Further Readings

Income tax being direct tax is a major source of revenue for the Central Government. The entire amount of income tax collected by the Central Government is classified under the head: (a) Corporation Tax (Tax on the income of the companies) and (b) Income Tax (Tax on income of the non-corporate assesses).

CONSTITUTIONAL PROVISIONS

Under the Constitution of India, the legislative fields in entries 85 and 86 of the Union List in the Seventh Schedule specify Corporation tax and taxes on capital value of the assets, exclusive of agricultural land of individuals and companies. A tax on capital value of assets is a composite tax on the totality of all the assets owned by the company.

Article 366(6) of the Constitution defines corporate tax as follows: Corporate tax means any tax on income, so far as that tax is payable by companies and is a tax in case the following conditions are fulfilled:

(a) that it is not chargeable in respect of agricultural income;

(b) that no deduction in respect of tax paid by companies is by any enactments which may apply to the tax authorised to be made from dividends payable by the companies to individuals;

(c) that no provision exists for taking the tax so paid into account for computing for the purposes of Indian income tax, the total income of individuals receiving such dividends, or in computing the Indian income tax payable by, or refundable to, such individuals.

MEANING OF COMPANY UNDER SECTION 2(17) OF THE INCOME-TAX ACT

As per section 2(17), company means:

(i) any Indian company, or

(ii) any body corporate incorporated by or under the laws of a country outside India, or

(iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 (11 of 1922) or was assessed under this Act, as a company for any assessment year commencing on or before April 1, 1970; or (iv) any institution, association or body, whether incorporated

or not and whether Indian or non-Indian, which is declared by general or special order of the CBDT to be a company. Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years (whether commencing before the 1st day of April 1971, or on or after that date) as may be specified in the declaration.

CBDT Order

In cases where the CBDT specifies any association or body to be a company, it is essential that the order of the Board is taken to be valid only in respect of the assessment year or years specifically mentioned in the Board's order. The Board's power is specifically made exercisable in respect of past assessment year. In other words, the declaration of the Board does not automatically mean that the association or body would continue to be treated as a company for all purposes and for all assessment years. Whilst declaring any institution, association or body as a company, the Board has also to justify itself that they have characteristics as would generally enable them to be recognized as companies in common parlance as sometimes, such a declaration may be sought for by institutions for avoiding taxes.

The power of the to declare any foreign association or body as a company is absolute and unqualified and the Board would normally declare such association or body to be a 'company' only after taking into consideration the benefit to the revenue (Section 119 read together with Section 295 of the Income Tax Act, 1961).

Liquidating Company

A Company in liquidation is also a "company" and the Income tax authorities are entitled to call upon the liquidator to make a return of the company's income. Likewise, penalty proceedings can also be initiated against a company in liquidation for a default committed prior to liquidation. Thus, the expression Company as defined in the Income Tax Act has a much wider connotation than what is normally understood by a 'Company' under the Companies Act.

Companies established under section 25 of the Companies Act,1956

In order to be regarded as a taxable entity under the Income Tax Act, 1961, it is not essential that the company must always have a share capital and must have been formed with a profit motive. Even companies having no share capital and those, which are limited by guarantee, are assessable as companies for income-tax purposes even if such companies may have been formed without any profit motive and registered under Section 25 of the Companies Act 1956 (e.g. Chambers of Commerce etc.). Under Section 28 (iii) of the Income tax Act, 1961, trade, professional or similar associations are liable to tax in respect of the income they derive from rendering of specific services to their members. Accordingly, in respect of specific services to their members, such entities, even if they are non-profit making, would become liable to tax under the Income tax Act as a company in respect of their income from business although they may not have been specifically formed to carry on any business with a view to make profit. A statutory corporation established under the Act of Parliament, Government companies and the

State Government companies who carry on a trade or business would also be treated as a company for all purposes of income tax.

Discontinuance of Business

A company or for that matter, any assessee who discontinued their business are statutorily required to intimate to the Assessing Officer within 15 days (Section 176 of the Income Tax Act, 1961).

Assessment of Companies

For assessment to income tax, each company is assessed separately although the companies might be interrelated or inter-connected; for instance, holding and subsidiary companies must be assessed separately to Income tax in respect of the profits made by each of them since they have a separate and distinct legal existence. The Supreme Court in the case of Mrs. Bacha F. Guzdar v. CIT (1955) 27 ITR 1(SC) has held that dividend received from a company earning agricultural income is not an agricultural income in the hands of the shareholders and therefore does not qualify for exemption under Section 10 (1) which grants exemption to agricultural income.

CATEGORIES OF COMPANIES UNDER THE INCOME TAX ACT, 1961

In continuation of our, earlier discussion on definition of company, we will now discuss broadly the different categories of companies:

Indian Company

Section 2(26) of the Income Tax Act, 1961 defines the expression 'Indian Company' as a company formed and registered under the Companies Act, 1956 and includes:

(a) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir, and the Union Territories specified in (e) below);

(b) any corporation established by or under a Central, State or Provincial Act;

(c) any institution, association or body which is declared by the Board to be a company under Section 2(17) of the Income Tax Act, 1961;

(d) in the case of State of Jammu & Kashmir, any company formed and registered under any law for the time being in force in that State; and

(e) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory; Provided that the registered or, as the case may be, principal office of the company, corporation, institution, association or body in all cases is in India.

From the above definition, it may be seen that statutory corporations as well as government companies are automatically treated as Indian companies for purposes of the Income Tax Act, 1961. The definition of an Indian company has been specifically given under the Income Tax Act, 1961 because of the fact that Indian companies are entitled to certain special tax benefits under this Act. It must be noted that all companies falling within the definition given in Section 2(17) of the Act are not necessarily Indian companies whereas all Indian companies are companies within the meaning of Section 2(17) of the Act. "Infrastructural capital company" as defined under Section (26A) means

such company which makes investments by way of acquiring shares or providing long-term finance to any enterprise or undertaking wholly engaged in the business referred to in Sub-section (4) of Section 80-IA or Sub-section (1) of Section 80-IAB or an undertaking developing and building a housing project referred to in Sub-section (10) of Section 80-IB or a project for constructing a hotel of not less than three-star category as classified by the Central Government or a project for constructing a hospital with at least one-hundred beds for patients.

Domestic Company

Section 2(22A) of the Income Tax Act, 1961, defines domestic company as an Indian company or any other company which, in respect of its income liable to tax under the Income Tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income. From this definition, it is clear that all Indian companies are domestic companies while all domestic companies need not necessarily be Indian companies. In other words, a non-Indian company would be considered as a domestic company if it makes the prescribed arrangements for the declaration and payment of dividends in India on which tax is deductible under Section 194. These arrangements are as follows:

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

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

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

Foreign Company

Section 2(23A) of the Income tax Act defines foreign company as a company, which, is not a domestic company. However, all non-Indian companies are not necessarily foreign companies. If a non-Indian company has made the prescribed arrangements for declaration and payments of dividends within India, such a non-Indian company must be treated as a "domestic company" and not as a "foreign company".

COMPANY IN WHICH PUBLIC ARE SUBSTANTIALLY INTERESTED (A WIDELY-HELD COMPANY)

Section 2(18) of the Income Tax, Act defines the expression "company in which the public are substantially interested". A company is said to be one in which public are substantially interested in the following cases, namely –

(i) If it is a company owned by the Government or the Reserve Bank of India or in which not less than 40 per cent of the shares, whether singly or taken together, are held by the Government or the Reserve Bank of India or a corporation owned by the Reserve Bank of India; or

(ii) If it is a company which is registered under Section 25 of the Companies Act, 1956; or

(iii) If it is a company, having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by an order of the Board (CBDT) to be a company in which the public are substantially interested. However, such a company shall be deemed to be one in which the public are substantially interested only for the assessment year(s) as may be specified in the declaration; or (iv) If it is a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under Section 620A of the Companies Act, 1956 to be a Nidhi or Mutual Benefit Society; or

(v) If it is a company in which shares carrying not less than 50 per cent of the voting power have been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year beneficially held by, one or more cooperative societies; or

(vi) If it is a company which is not a private company as defined in Section 3 of the Companies Act, 1956 and equity shares of the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in the profits, i.e. preference shares) were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India;

(vii) If it is a company which is not a private company within the meaning of the Companies Act, 1956, and the shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50 per cent (40 per cent in case of an industrial company) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant accounting year beneficially held by (a) the Government, or (b) a corporation established by a Central or State or Provincial Act, or (c) any company in which the public are substantially interested or a wholly owned subsidiary company. Industrial Company means an Indian company where business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power.

It may be noted that, a public company under the Companies Act, 1956 need not necessarily fall within the meaning of a company in which the public are substantially interested under the Income-tax Act, 1961 because a public company under the Companies Act, 1956 may be considered as one in which the public are not substantially interested under the Income-tax Act, 1961 after considering the nature and extent of shareholding.

Closely held company

A Company in which the public is not substantially interested is known as a closely held company. The distinction between a closely held and widely held company is significant from the following viewpoints. (i) Section 2(22) (e), which deems certain payments as dividend, is applicable only to the shareholders of a closely-held company; and

(ii) A closely held company is allowed to carry forward its business losses only if the conditions specified in Section 79 are satisfied.

TAX INCIDENCE UNDER INCOME TAX ACT, 1961

As you know, the incidence of Income tax depends upon the residential status of a company in India during the relevant previous year. A Company may be either resident or non-resident in India, i.e., company can not be ordinary or non-ordinary resident. According to Section 6(3) of the Act, a company is said to be resident in India (resident company) in any previous year, if:

(i) It is an Indian company; or

(ii) During that year, the control and management of its affairs is situated wholly in India. If one of the above two tests is not satisfied the company would be a non-resident in India during that previous year.

According to Section 5(1) of the Act, the total income of a resident company would consist of:

(i) income received or deemed to be received in India during the previous year by or on behalf of such company;

(ii) income which accrues or arises or is deemed to accrue or arise to it in India during the previous year;

(iii) income which accrues or arises to it outside India during the previous year.

It is important to note that under clause (iii) only income accruing or arising outside India is included. Income deemed to accrue or arise outside India is not includible in the hands of residents. Hence, net dividends received from foreign companies are includible in income and not the gross dividends [CIT v. Shaw Wallace & Co. Ltd. (1981) 132 ITR 466].

In this context, the Calcutta High Court had followed the Supreme Court's decision in Commissioner of Income tax
v. Clive Insurance Co. Ltd. (1978, 113 ITR 636) holding that the assessee could be said to have paid Income Tax in U.K, by deduction or otherwise, in respect of the net dividend so as to be eligible for relief contemplated
by Section 49D of the Indian Income Tax Act, 1922. Following the Supreme Court's decision, the Bombay High Court held in the case of Commissioner of Income tax v. Tata Chemicals Ltd. (1986, 162 ITR 556) that the
assessee was entitled to double taxation relief under Section 91 of the Income Tax Act, 1961 in respect of dividends from the United Kingdom. Following its decision in the case of Shaw Wallace & Co. Ltd. (supra), the Calcutta High Court held in the case of the same assessee (1983, 143 ITR 207) that dividends from foreign companies are to be assessed not on the gross amount of the dividends but on the gross amount of the dividends less tax deducted there from in foreign countries. In other words, only the net foreign dividends are to be included in the total income of a resident assessee under Section 5(1)(c) of the Income Tax Act, 1961. Under Section 5(2) of the Act, the total income of non-resident company would consist of:

(i) Income received or deemed to be received in India in the previous year by or on behalf of such company;

(ii) Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year.

The decision of the Supreme Court in the case of Standard Triumph Motor Co. Ltd. v. CIT (1993) 201 ITR 391 to the effect that when an Indian resident passes an entry crediting a non-resident with amount payable to him, that would tantamount to the latter receiving income in India, is having grave consequences. In this case, the royalty payable to non-resident in pound sterling was credited to the non-residents accounts in the books of the assessee. The Supreme Court held that the plea to accept royalty income in U.K. was immaterial because the amount was available for the use of the non-resident in India in any manner he liked. Hence, the income was received in India. In the wake of this decision, non-residents who have all along been held to be not liable to Indian Income tax if the contract was signed outside India, executed outside India and paid for outside India could well fall into the Indian-tax net, should their clients/customers credit them for the amount due before making payments to them outside India. In other words, a non-resident's tax liability depends upon the accounting entry passed by his client customer.

REVIEW QUESTIONS

1. What do you understand by "Book Profit" in the context of Minimum Alternate Tax.
2. Define the following keeping in view the points involved while planning tax:
(a) Indian Company
(b) Domestic Company
(c) Foreign Company
(d) Company in which public is substantially interested.
(e) Closely-held Company.
3. Explain the significance of classification of companies under the Income tax Act, 1961 and their impact on the tax liability.
4. Explain how is the residential status of a company determined under the Income tax Act, 1961.
5. Explain how (i) the scope of tax liability on total income and, (ii) the rate of the tax applicable to a company are determined?
6. Explain the concept of MAT and its rationale.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

UNIT-9 COLLECTION AND RECOVERY OF TAX

CONTENTS

- Collection And Recovery Of Tax
- Payment Of Income-Tax
- Consequence In The Event Of Default E-Tds Return :
- 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]
- Interest For Belated Payment Of Income-Tax [Section 220(2)]
- Interest For Default In Furnishing Return Of Income(Section 234a)
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- Interest For Deferment Of Advance Tax (Section 234c)
- Interest Receivable By The Assessee
- Section 244a (Interest On Refunds)
- Review Questions
- Further Readings

The Tax on income is collected in four ways- Tax Deduction at source (TDS), Advance Tax, direct payment of income-tax by the assessee on self-assessment basis and payment after the assessment is made by the Assessing Officer.

COLLECTION AND RECOVERY OF TAX

(a) Notice of Demand (Section 156) (Rules 15, 38, Forms 7, 28)

When any tax, interest penalty, fine or any other sum is payable in consequence of any order passed under this Act, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable.

(b) Intimation of loss (Section 157)

When in the course of the assessment of the total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set off against the income in subsequent years, the Assessing Officer shall notify to the assessee by an order in writing the amount of the loss as computed by him for the purposes of carry forward and set off.

(c) Assessee in Default

The amount specified in the notice of demand shall be paid within 30 days of the service of the notice at the place and to the person mentioned in the notice. If the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of 30 days is allowed he may, with the prior approval of the Joint Commissioner reduce the period as he thinks fit (Section 220).

If the amount specified in the notice of demand is not paid within the period mentioned in the notice, the assessee shall be liable to pay simple

interest at one and one-fourth per cent for every month or part of a month comprised in the period commencing from the day immediately following the end of the 30 days or shorter period, as allowed, and ending with the date of payment of the tax. If the assessee is not in a position to pay the amount in the prescribed time, he may submit an application to the Assessing Officer before the expiry of the due date of the payment. On receipt of such application, the Assessing Officer may extend the time for payment or allow payment by instalments, subject to such conditions as he may think fit to impose. If the amount is not paid as mentioned above, the assessee shall be deemed to be in default and shall be liable to pay in addition to the amount of the arrears and the amount of interest, by way of penalty such amount as the Assessing Officer may direct. In the case of continuing default, he shall be liable to pay such further amount as the Assessing Officer may, from time to time, direct. However, the total amount of penalty shall not exceed the amount of tax in arrears.

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in the prescribed form specifying the amount of arrears due

from the assessee and shall proceed to recover from such assessee the amount specified in the certificate (being the statement referred to above) by one or more of the modes mentioned below, in accordance with the rules laid down in the Second Schedule.

(A)(i) attachment and sale of the assessee's movable or immovable property;

(ii) arrest of the assessee and his detention in prison; and

(iii) appointing a receiver for the management of the assessee's movable and immovable properties (Section 222).

(B) The Assessing Officer may also recover the tax by any one or more of the following modes of recovery:

(i) attachment of salary;

(ii) garnishee order;

(iii) from a court;

(iv) sale of movable property (Section 226);

(C) Through State Government (Section 227);

(D) In pursuance of agreement with foreign countries (Section 228A);

(E) By suit or under other law (Section 232).

Note: For details please refer to the relevant sections of the Act.

PAYMENT OF INCOME-TAX

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

(i) deduction of tax at source in respect of income by way of salaries, interest on securities, interest other than interest on securities, winnings from lotteries and crossword puzzles, winnings from horse-race, insurance commission, dividends, payment to contractors or subcontractors and payments to nonresidents;

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

(iii) direct payment of income-tax by the assessee on self-assessment; and

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

The provisions relating to tax deduction at source and payment of tax in advance of assessment are being discussed below:

(a) Deduction of Tax at Source

Sections 192 to 206 of the Income-tax Act lay down the provisions relating to deduction of tax at source. The provisions in respect of different incomes are as follows:

(1) Salary (Section 192)

(i) Any person responsible for paying any income (employer) chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the rates applicable to the estimated income of the assessee (employee) under this head for that financial year. It is not the total income that is subject to deduction of tax at source but the estimated income under the head "Salaries" that is important. W.e.f. August 1, 1998, an assessee having an income under the head 'salaries' may furnish in the prescribed manner giving the details of the losses under the head 'Income from House Property' to the person responsible for making the payment who shall 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.

No tax will be required to be deducted at source in case the Gross Total income does not exceeds

– ` 2,00,000 in case of individual below 60 years of age.

– ` 2,50,000 in case of individual having the age of 60 years but below 80 years
– ` 5,00,000 in case of individual having the age of 80 years and above.
Where the salary is payable to an assessee outside India in foreign currency its value in rupees shall be the telegraphic transfer buying rate of such currency as on the date on which the tax is required to be deducted at source. 'Telegraphic transfer buying rate' means the rate of exchange adopted by the State Bank of India for buying such currency as made available to the bank through a telegraphic transfer.
Every employer shall file a quarterly return in Form No. 24Q within 15 days from end of quarter and for the quarter ending on 31st March will be submitted on 31st May following the close of the relevant financial year showing:
(a) the name and address of every employee who is drawing such amount as may be prescribed;
(b) the amount of income so received by or so due to each such person; and
(c) the amount of tax deducted and deposited from the income of such person.
The employer shall issue a certificate of deduction of tax to the employee in Form No. 16. Also, a person responsible for paying any income chargeable under the head "Salaries" is required to furnish, to the person to whom such payment is made, a statement giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof in such form and manner as may be prescribed.
(2) Interest on Securities (Section 193)
The person responsible for paying to a resident any income by way of interest on securities shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier deduct income-tax at the rates in force on the amount of the interest payable.
Credit of any income by way of interest on securities to any account, whether called "Interest payable account" or "Suspense account" or by any other name in the books of account of the person liable to pay such income, is, for the purposes of Section 193, deemed to be credit of such income to the payee and attracts applicability of the provisions of Section 193. However, tax shall not be deducted from the interest on the following securities:
(i) 4-1/4% National Defence Bonds, 1972 held by a resident individual.
(ii) 4-1/4% National Defence Loan, 1968 and 4-3/4% National Defence Loan, 1972 and National Development Bonds.
(iii) 7 year National Savings Certificates IV Issue.
(iv) Debentures issued by Co-operative Society (including Co-operative Land Mortgage Banks or Cooperative Land Development Banks) or any other institution or authority as the Central Government may specify in the Official Gazette.
(v) Gold bonds provided the assessee is a resident individual and the nominal value of the bonds did not exceed ` 10,000 at any time during the period to which the interest relates.
(vi) Securities of the Central Government or State Government.

(vii) Any interest payable to an individual or a Hindu undivided family, who is resident in India, on any debenture issued by a company in which the public are substantially interested, if

(a) the amount of interest or, as the case may be, the aggregate amount of such interest paid or likely to be paid on such debenture during the financial year by the company to such individual or Hindu undivided family does not exceed five thousand rupees; and

(b) such interest is paid by the company by an account payee cheque.

(viii) Interest on such debentures as are issued by a statutory corporation or a Government company.

(ix) Interest payable to the Life Insurance Corporation of India established under the Life Insurance Corporation Act, in respect of any securities owned by it or in which it has full beneficial interest; or

(x) any interest payable to the General Insurance Corporation of India (hereafter in this clause referred to as the Corporation) or to any of the four companies (hereafter in this clause referred to as such company), formed by virtue of the schemes framed under Sub-section (1) of Section 16 of the General Insurance Business (Nationalization) Act, 1972 (57 of 1972), in respect of any securities owned by the Corporation or such company or in which the Corporation or such company has full beneficial interest; or

(xi) any interest payable on any other insurer in respect of any securities owned by it or in which it has full beneficial interest."

TDS can be made at the time of payment or at the time of credit to the account of the payee or transfer to interest payable amount or suspense account, whichever comes earlier. The identity of the person in whose hand it is 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.
(ix) income credited or paid by the Central Government under Income Tax Act, 1961 or Indian Income Tax Act, 1922 or the Estate Duty Act, 1953 or the Wealth Tax Act, 1957 or the Gift Tax Act or the Super Profits Tax Act, 1963 or the Companies (Profits) Surtax Tax Act, 1964 or the Interest Tax Act, 1974.

(x) income which is paid or payable by an infrastructure capital company or infrastructure capital fund or a public sector company in relation to a zero coupon bond issued on or after the 1st day of June 2005 by such company or fund or public sector company.

(xi) to such income credited or paid by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid during the financial year does not exceed fifty thousand rupees.

The responsible person may, at the time of making any deduction increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of any previous deductions or failure to deduct
during the financial year.

The responsible person shall file a shall file quarterly return in Form No. 26Q with in 15 days from end of quarter and for the quarter ending on 31st March will be submitted by 15th May following the close of the financial year showing the names and addresses of the person and the amount paid or credited to each of such person. With effect from 1.6.2002, individuals and HUF covered under Section 44AB(a) and (b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ` 1 crore (or receipts from the profession ` 25 Lakh), are also required to deduct tax at source.

Cheque discounted charges are different from interest payments and provisions of Section 194A are not attracted. ITO v. A.S. Babu Sah (2003) 86 ITD 283 (Mad.)

(5) Winnings from Lotteries or Crossword Puzzles (Section 194B)

The person responsible for paying to any person any income by way of winnings from lotteries or crossword puzzles or card game and other game of any sort, an amount exceeding `10,000 shall deduct tax at the prescribed
rates at the time of such payment and a statement in Form No. 26 has to be filed by the end of the month of June
falling in the financial year immediately following the previous year. No such deduction shall be made from any
such payment before 1.6.1972.

Rate of Tax:

The prescribed rate is 30%. No surcharge,education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%. **Important Points**

(i) When the prize is given partly in cash and partly in kind, income-tax will be deducted from cash prize with reference to the aggregate amount of the cash prize and the value of the prize in kind.

(ii) No income-tax will be deducted from the prize given only in kind.

(iii) When the prize is given in instalments, the tax will be deducted only at the time of actual payment of each instalment.

(iv) Income-tax is not deductible from the income by way of bonus or commission paid to lottery agent or sellers of lottery tickets on the sales made by them.

Prizes won by lottery agent under "Lucky dip draws" are lotteries for the purposes of deduction of tax at source (Circular dated 11-2-1980).

(6) Winnings from Horse Races (Section 194BB)

Income-tax has to be deducted at source from any income by way of winnings from horse races at such rate as may be prescribed by the annual Finance Act. Deduction of tax at source will be made only in cases where the income by way of winnings from horse races to be paid to a person exceeds `5,000. The obligation to deduct tax at source will apply only where such winnings are paid by a book maker or a person to whom a licence has been granted by the Government under any law for the time being in force for horse racing in any race course or for arranging for wagering or betting in any race course.

Rate of Tax:

The prescribed rate is 30%. No surcharge,education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 30%.

(7) Payment to Resident Contractor or Sub-contractor (Section 194C)

Any person responsible for paying to any of the contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Rate of Tax:

(i) 1% where the payment is being made or credit is being given to an individual or a Hindu undivided family; (ii) 2% where the payment is being made or credit is being given to a person other than an individual or a Hindu undivided family, of such sum as income-tax on income comprised therein.

– No surcharge, education cess or SHEC shall be added from 1st October, 2009.

– When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st
April 2010 @ 20%. No individual or Hindu undivided family shall be liable to deduct income-tax on the sum credited or paid to the contractor
No deduction shall be made from the amount of any sum credited or paid to, the contractor, if such sum does not
exceed ` 30,000 Provided that where the aggregate of the amounts credited or paid during the financial year exceeds `75,000 the person responsible for paying shall be liable to deduct income-tax.

No deduction shall be made from any sum paid or credited during the previous year to the account of a contractor during the course of business of plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number, to the person paying or crediting such sum.

(8) Insurance Commission (Section 194D)

Any person responsible for paying to a resident any income by way of commission or otherwise for soliciting or procuring insurance business (including continuance or renewal of policies) shall, at the time of crediting the account of the payee or at the time of payment thereof,

whichever is earlier. No deduction shall be made from the amount of any sum credited or paid to, if such sum does not exceed `20,000.

Rate of Tax:

The prescribed rate is 10%. No surcharge,education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

(9) Payment in respect of Deposits under National Savings Scheme etc. (Section 194EE)

The person responsible for paying to any person any amount referred to in Section 80CCA(2)(a) shall, at the time of payment thereof, deduct income-tax at the rate of 20%. No deduction shall, however, be made under Section 194EE where the amount of such payment or the aggregate of such payment to the payee during the financial year is less than ` 2,500. Further, nothing contained in Section 194EE shall apply to the payment of the said amount to the heirs of the assessee.

Rate of Tax:

The prescribed rate is 20%. No surcharge,education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

(10) Commission, etc. on sale of lottery tickets (Section 194G)

Any person paying any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets on amounts exceeding ` 1,000 shall deduct income-tax at the rate of 10%.No surcharge,education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.irrespective of the fact whether the payment is made in cash or by the issue of a cheque or draft or by any other mode. The provisions of Section 194G have been extended to any account, whether called 'suspense account' or by any other name in the books of account of the
person liable to pay.

(11) Commission or Brokerage (Section 194H)

Any person, not being an individual or a Hindu Undivided Family, who is responsible for paying, or after 1st day of June, 2001, to a resident any income by way of commission (not being insurance commission referred to in Section 194D) or brokerage, shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of 10% No surcharge,education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect
from 1st April 2010 @ 20%..

Provided that no deductions shall be made under this section in a case where the amount of such income or, asthe case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paidduring the financial year to the account of, or to, the payee, does not exceed ` 5,000 Individuals and HUF covered under Section 44AB(a) and

(b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ` 1 crore (or receipts from the profession ` 25,00,000), are also required to deduct tax at source.

(12) Rent (Section 194-I)

A new Section 194-I in the Income-tax Act relating to deduction of Income-tax at source has been inserted by the Finance Act, 1994.

Any person other than an individual or a HUF who is responsible for paying to a resident any income by way of rent is required to deduct tax from rent if such rent is in excess of ` 1,80,000 per financial year. Tax is to be deducted @ 2% for use of any machinery or plant or equipment; and @ 10% for the use of any land or building (including factory building) or furniture or fittings No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

(13) Payment on transfer of certain immovable property other than agricultural land (Section 194-IA)

Any person, being a transferee, responsible for paying (other than the person referred to in section 194LA) to a resident transferor any sum by way of consideration for transfer of any immovable property (other than agricultural land), shall, at the time of credit of such sum to the account of the transferor or at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to one per cent of such sum as income-tax thereon.

No deduction shall be made where the consideration for the transfer of an immovable property is less than 50 lakh rupees.

(a) "agricultural land" means agricultural land in India, not being a land situate in any area referred to in
items (a) and (b) of sub-clause (iii) of clause (14) of section 2;

(b) "immovable property" means any land (other than agricultural land) or any building or part of a building.

The provisions of section 203A shall not apply to a person required to deduct tax in accordance with the provisions of this section.

Procedure to be followed for Depositing of Tax

This section is applicable on 1st June 2013, there was a confusion regarding the depositing the tax and claim of such tax deposited. Whether the deductor would have to apply for a TAN and how and when the tax is to be deposited. As per section 194-IA, every person (even individuals) making a payment for consideration of an immovable property, not including agricultural land, will withhold tax @ 1% of the transaction amount. As per notification no. 39/2013 dated 31 May 2013 the following things have been made clear:

1. Depositing of withholding tax.
2. Issuance of certificates for such tax
3. Filing a return of withholding tax.

The following procedure is followed:

The amount deducted under section 194-IA shall be deposited with the Central Government within 7 days from the end of the month in which the amount was deducted. For example, if amount is deducted on 15th

June, then amount shall be paid to the credit of Central Government by 7th July.

TDS payment made u/s 194-IA is to be necessarily accompanied by a challan-cum-statement in Form No.26QB.

The amount shall be deposited electronically within the time specified above with the RBI or the SBI or any other authorized bank. Deductor is liable to furnish the certificate of the tax deducted at source in Form No. 16B to the deductee within 15 days from the due date of furnishing Form No. 26QB. TDS deductor shall provide a certificated under Form 16B which is to be generated online from the web portal.

(14) Professional and technical fees (Section 194J)

Any person other than an individual or a HUF is required to deduct tax @ 10% on professional or technical fees or on any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or royalty, or any sum referred to in clause (va) of section 28 at the time of payment or credit whichever is earlier if the aggregate of such fees given to a person is likely to be more than ` 30,000 in a previous year. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

(15) Payment of compensation on acquisition of capital asset (Section 194LA)

This section has been inserted by Finance (No. 2) Act, 2004 w.e.f. 1.10.2004. It applies to any person responsible for paying to a resident any sum being in the nature of compensation or enhanced compensation or consideration or enhanced consideration on account of compulsory acquisition of any asset under any law for the time being in force. Such person, at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode whichever is earlier, shall deduct an amount equal to 10% and no surcharge,education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.of such sum as income tax on income comprised therein.

However, no deduction shall be made where the amount of such payment or aggregate of such payments during the financial year does not exceed ` 2 lakh.

(16) Income by way of interest from infrastructure debt fund (Section 194LB)

Where any income by way of interest is payable to a non-resident, not being a company, or to a foreign company, by an infrastructure debt fund referred to in clause (47) of section 10, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon @5%.

(17) Income by way of interest from Indian company engaged in certain business (Section 194LC)

Where any income by way of interest is payable to a non-resident, not being a company or to a foreign company by a specified company, the

person responsible for making the payment, shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct the income-tax thereon @5%.

(2) The interest shall be the income by way of interest payable by the specified company,-

(i) in respect of monies borrowed by it at any time on or after the 1st day of July, 2012 but before the 1st day of July, 2015 in foreign currency, from a source outside India, –

(a) under a loan agreement; or

(b) by way of issue of long-term infrastructure bonds, as approved by the Central Government in this behalf; and

(ii) to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf; having regard to the terms of the loan or the bond and its repayment.

(a) "foreign currency" shall have the meaning assigned to it in clause (m) of section 2 of the Foreign Exchange Management Act, 1999(42 of 1999);

(b) "specified company" means an Indian company.

(18) Income by way of interest on certain bonds and Government securities (Section 194LD)

Any person who is responsible for paying to a person being a Foreign Institutional Investor or a Qualified

Foreign Investor, any income by way of interest shall, at the time of credit of such income to the account of the

payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax @5%.

The income by way of interest shall be the interest payable on or after the 1st day of June, 2013 but before the 1st day of June, 2015 in respect of investment made by the payee in –

(i) a rupee denominated bond of an Indian company ; or

(ii) a Government security:

However, the rate of interest in respect of bond referred to in clause (i) shall not exceed the rate as may be notified by the Central Government.

(a) "Foreign Institutional Investor" shall have the meaning assigned to it in clause (a) of the Explanation to section 115AD;

(b) "Government security" shall have the meaning assigned to it in clause (b) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(c) "Qualified Foreign Investor" shall have the meaning assigned to it in the Circular, No. Cir/IMD/DF/14/2011, dated the 9th August, 2011, as amended from time to time, issued by the Securities and Exchange Board of India, under section 11 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).

(19) Payments of other sums to Non-residents (Section 195)

Any person responsible for paying to a non-resident or foreign company any interest or any other sum chargeable to income-tax in India, not being salaries, shall at the time of payment, deduct tax at the rates in

force. However, no such deduction shall be made in respect of any dividends referred to in Section 115-O. In the case of interest payable by the government or a public sector bank or a public financial institution within the meaning of Section 10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode.

Credit of any amount to 'Suspense Account' or any other account in the books of account of the person liable to pay such income is also deemed to be 'credit' of the income to the account of the payee and makes the provisions of this section applicable to such cases. If the person responsible for such payments, feels that the whole amount would not be income chargeable in the case of recipient he may make an application to the Assessing Officer to determine the chargeable portion and he shall deduct tax on the sum so determined. Further, the assessee may apply to the Assessing Officer to grant a certificate for either no deduction of tax at source or deduction at a lower rate. If the Assessing Officer is satisfied, he can issue a certificate accordingly and the certificate shall remain in force till the expiry of the period specified therein or its cancellation by the Assessing officer whichever is earlier. As a result of amendment made by the Finance (No. 2) Act, 1991 with effect from 1.10.1991 in Section 195, reference to the word 'dividend' has been omitted. Payment made by Indian company to U.S. Company for use of its data base is not subjected to TDS under Section 195 of the Income Tax Act. - WIPRO Ltd. v. I.T.O. (2005) 94 ITD 9 (Bang.)].

(20) Other Provisions

Section 196 provides that no deduction of tax shall be made (notwithstanding anything contained in the foregoing provisions of Chapter XVII) by any person from any sums payable to :

(i) the Government; or

(ii) the Reserve Bank of India; or

(iii) a corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income-tax on its income; or

(iv) a Mutual Fund specified under Section 10(23D);

where such sum is payable to it by way of interest or dividend in respect of any securities or shares owned by it or in which it has full beneficial interest, or any other income accruing or arising to it. Where in the case of any income of any person, the Assessing Officer is satisfied that the total income of the person justifies the deduction of income-tax at any lower rate or no deduction of income-tax, he shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate. Where such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in the certificate or deduct no tax, as the case may be (Section 197).

With effect from 1st January 2013, no tax shall be deducted on the following payments where such payment is made by a person to a bank listed in the Second Schedule to the Reserve Bank of India Act, 1934, excluding a foreign bank;

(i) bank guarantee commission;

(ii) cash management service charges;
(iii) depository charges on maintenance of DEMAT accounts;
(iv) charges for warehousing services for commodities;
(v) underwriting service charges;
(vi) clearing charges (MICR charges);
(vii) credit card or debit card commission for transaction between the merchant establishment and acquirer bank.

(21) Income from units

According to Section 196B the person responsible for making the payment in respect of units referred to in Section 115AB or by way of long-term capital gains arising from the transfer of such units is payable to an offshore fund shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of ten percent.

(22) Income from foreign currency bonds or shares of Indian Company

With effect from June 1, 1992, Section 196C has been inserted to provide for a deduction of income-tax at the rate of ten percent from the interest income or dividend income in respect of bonds or shares referred to in Section 115AC or by way of long-term capital gains arising from the transfer of such bond or share capital to a non-resident. However, no such deduction shall be made in respect of any dividends referred to in Section 115-O. The person responsible for making such payment shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode whichever is earlier, deduct the income-tax thereon @ 10%.

(23) Income of Foreign Institutional Investors from securities

According to Section 196D, where any income in respect of securities referred to in clause (a) of Sub-section (1) of Section 115AD is payable to a Foreign Institutional Investor, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier, deduct income-tax at the rate of twenty per cent. However, no such deduction shall be made in respect of any dividends referred to in Section 115-O.
Also no deduction of tax shall be made from any income by way of capital gains arising from the transfer of securities referred to in Section 115AD payable to a Foreign Institutional Investor.

(24) No deduction to be made in certain cases

Section 197A provides that no deduction of tax at source is to be made from (i) interest on securities, (ii) dividends, and (iii) payments in respect of deposits under NSS, etc. if the following conditions are satisfied:
(i) The recipient of such income is an individual and resident in India.
(ii) Such person furnishes a declaration in writing in duplicate, in the prescribed form and verified in the prescribed manner, to the payer of such income to the effect that the tax on his estimated total income of the previous year in which such income is to be included for computing his total income will be nil. Sub-section 197A(1A) has been inserted with effect from June 1, 1992. This sub-section provides that in case of interest other than interest on securities, a declaration referred to above

can be furnished by any person (other than a company or a firm). The payer of the aforesaid income will deliver to Chief Commissioner or Commissioner of Income-tax one copy of the declaration (received from the recipient of income) on or before the 7th day of the month next following the month in which the declaration is furnished. If he fails to do so he will be liable to a penalty of an amount which shall not be less then one hundred rupees but which may extend to two hundred rupees for every day during which the default continues.

(25) Tax deducted is income received (Section 198)

The tax deducted at source is deemed to be the income received, by the assessee for the purpose of computing his income.

(26) Certificate of tax deducted (Section 203)

The person who deducts tax has to issue a certificate in the prescribed form to the person from whose payments deduction has been made, showing therein the particulars of payment, the date of tax deducted at source and the date of its credit to the Central Government. It is on the basis of this certificate that the payee can claim credit for tax paid on his behalf and can claim refund, if any, due to him on the basis of tax liability for the relevant year.

(27) Consequence in the event of default (Section 201)

Where any person, including the principal officer of a company,

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in sub-section (1A) of section 192, being an employer, does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax:

However, any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident (i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income, and the person furnishes a certificate to this effect from an accountant in form 26A. No penalty shall be charged under section 221 from such person, unless the Assessing Officer is satisfied that such person, without good and sufficient reasons, has failed to deduct and pay such tax.

If a person responsible for deduction of tax at source fails to deduct the appropriate tax or, after making the due deduction fails to deposit it into the Government treasury, he shall be deemed to be an assessee in default and shall be liable to:

(i) Payment of the whole or any part of the tax as due

(ii) Interest at the rate of 1 per cent per month or part of the month on the tax from the date on which such tax was deductible to the date on which such tax is deducted; and

(iii) Interest at the rate of 1½ per cent per month or part of the month on the tax from the date on which such tax was deducted to the date on which such tax is actually paid;

However, in case any person, including the principal officer of a company fails to deduct the whole or any part of the tax on the sum paid to a resident or on the sum credited to the account of a resident but is not deemed to be an assessee in default, the interest shall be payable from the date on which such tax was deductible to the date of furnishing of return of income by such resident.

(iv) Penalty which may be as high as the amount of the tax in default, however, no penalty shall be charged under Section 221 from such person unless the Assessing Officer is satisfied that such person has, without good and sufficient reasons, failed to deduct and pay the tax; and

(v) Prosecution - where the amount of tax which the responsible person has failed to deduct or pay exceeds ` ,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.

E-TDS Return

E-TDS return is a 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 deductros 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 alson appointed National Securities Depository Limited (NSDL) as e-TDS intermediatory. E-TDS return can be filed at any of the TIN-FC opened by the e-TDS intermediatory for this purpose. The due date for filing quarterly TDS return both electronic and conventional form remains the same.

E-Filing of quarterly statement of TDS is mandatory for the deductors where;

– The deductor is an office of the Government

– The deductor is the principal officer of a company

– The deductor is a person required to get his accounts audited under section 44AB in the immediately preceding financial year or

– The number of deductees records in a quarterly statement for any quarter of the financial year are twenty or more,

Other than the above, any other deductor may also opt to furnish the statement electronically.

ADVANCE PAYMENT OF TAX

The computation of advance tax liability, under different situations, is to be done as follows:

Section 207-219 of the Income Tax Act deals with the issues relating to advance payment of tax. In advance payment of tax, the assessee has to pay tax in a financial year under estimated income which is to be taxed in the subsequent assessment year. It follows the doctrine known as pay as you earn scheme.

ADJUSTMENT OF ADVANCE TAX

Under Section 219, the total advance tax paid by an assessee other than for interest be adjusted against the total tax liability computed under regular assessment. Under Section 234B of the Act where an assessee, who is liable to pay advance tax, under Section 208 has failed to pay such tax or where the advance tax paid under Section 210 is less than 90% of the assessed tax, he shall be liable to pay interest @ 1% for every month or part of the month. Assessee has to pay advance tax even in respect of book profit tax under Section 115JB otherwise it is liable for interest under Sections 234B and 234C.

It is kind of mandatory payment of tax, assessed by the assessee himself on income before completion of the Financial Year.

LIABILITY OF THE ASSESSEE

It is obligatory for an assessee to pay advance tax where the advance tax payable is `10,000 or more (Section 208).

In order to reduce the compliance burden on senior citizens exemption from payment of advance tax section 207 has been amended to provide that resident individual –

(1) not having any income chargeable under the head "Profits and gains of business or profession" and

(2) of age 60 years or more need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

Any payment of advance tax payable made before March 31 shall be treated as advance tax paid during the financial year. In case of public holiday or bank holiday, date of payment automatically falls in the next working day and for that delay, interest is not charged under Sections 234B and 234C vide Circular No. 676 dated 14.01.1994. Tax to be computed at the prevailing rate on the current income of the assessee, in a financial year.

ROLE OF ASSESSING OFFICER IN RELATION TO ADVANCE PAYMENT OF TAX

An Assessing Officer (AO) can order payment of advance tax if following conditions are satisfied:

(i) The assessee has already been assessed by way of regular assessment in respect of total income of any previous year.;

(ii) Failure to pay tax by such assessee.

(iii) The AO is of the opinion that such person is liable to pay advance tax on current year's income.
(iv) The order must specify the amount of advance tax and instalments in which advance tax has to be paid.
(v) Such order may be passed during the previous year but not later than last day of February.
(vi) The order must be made in writing.
The assessee can pay advance tax at a rate lower than assessment made by the AO and the department cannot object to such assessment, but he has to furnish his own estimate of income in Form No. 28A – Punjab Tractors Ltd. v. CIT (2004) 137 Taxman 211 (Punjab & Haryana).
For higher estimate made by the assessee, Form 28A is not required to be furnished.
The AO will find out the current income on the following basis:
(i) Total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment;
(ii) The total income returned by the assessee for any previous year subsequent to the previous year for which regular assessment is made. whichever is higher;
AO can revise his order passed under Section 210(3) [Section 210(4)]
If after making the order under section 210(3), but before 1st March (a) a return has been furnished by the assessee, (b) a regular assessment of the assessee is made, in respect of a later previous year, for a higher figure, then the Assessing officer may revise or amend his order.
On receipt of the order the assessee have to pay the advance tax accordingly.

REFUNDS (SECTIONS 237 to 245)

Refund means "to repay" or restore what was taken under the income-tax law. Refunds arise in those cases where the amount of tax paid by a person or on his behalf is greater than the amount with which he is properly chargeable for that year. Under the following circumstances the refunds may become due:
(i) The tax deducted at source is higher than the amount of tax payable, as determined on regular assessment;
(ii) The amount of advance tax paid or tax paid on the basis of self-assessment exceeds the tax payable as determined on regular assessment;
(iii) The tax determined and paid on the basis of regular assessment gets reduced as a result of rectification of mistake which had crept in the assessment or is reduced in appeal or revision;
(iv) The same income is taxed in India and in a foreign country and the assessee is entitled to double taxation relief.
For claiming refund it is necessary that the income in respect of which refund of tax is being claimed must have been included in his total income as per the return of Income.
Every claim for refund under this chapter shall be made in the prescribed Form (No. 30) within one year from the last day of the assessment year to which the claim is related. If the assessee has not filed the return of income
he must file the return alongwith the certificate/s of tax deducted at source, challans for payment of tax, salary certificate and/or tax paid in a

foreign country. The dividend warrants and other certificates should be filed in original, duly signed by the assessee, to evidence the ownership of shares etc., from which the income is derived. If, for some reason, the original certificates are not traceable, duplicates issued by the concerned companies may be furnished. However, in such cases an indemnity bond stating that the original certificates are not traceable and no refund in respect of such warrants had already been claimed, should also accompany the claim. Indemnity bond should be on a stamp paper of the prescribed value depending upon the amount of tax deduction.

Where refund arises on completion of assessment on account of excess payments of advance tax or on self assessment or it results on account of reduction in appeal, revision or rectification of mistakes, no formal application for refund is required. The Assessing Officer shall grant such refund on his own. However, where an assessment is set aside or cancelled by virtue of such an order and an order of fresh assessment is directed to be made, the refund if any, shall become due only on the making of fresh assessment. In cases where the assessment is annulled, the refund shall become due only of the amount of tax paid in excess of the tax chargeable on the total income returned by the assessee (Section 240).

However, the assessing officer is authorised to admit a belated refund claim subject to satisfying the following

conditions: (a) the refund arising as a tax deducted at source under Section 192, 193, 194, 194A, 194B, 194C, 194D and 195 or as a result of excess advance tax payments under Section 208, does not exceed ` 10,000;

(b) the returned income is not a loss, where the assessee claims the benefit of carry forward of the loss;

(c) the refund claimed is not supplementary in nature i.e. a claim for additional amount of refund after the completion of the original assessment for the same year; and

(d) the income of the assessee is not assessable in the hands of any other person under any provisions of the Act.

Whom to apply for refund?

Claim for refund should be preferred to the Assessing Officer having jurisdiction to assess the assessee. In bigger towns like Delhi, Bombay, Calcutta, Madras, separate Refund Circles have been opened to settle refund cases. However, these circles settle refund cases where income is restricted to ‘Other Sources’.

Who is entitled to refund

Any one of the following persons can apply for the refund:

(i) Owner of the income who has made excess payment;

(ii) Where the income of a person is included in the hands of another, only the latter is entitled to refund;

(iii) In case of death of the assessee, his legal representative;

(iv) In case of insolvency of the assessee - the receiver;

(v) In case of liquidation of a company - the liquidator of the company;

(vi) In case of minor or incapable assessee - the guardian of the minor or incapable;

(vii) In case of non-resident assessee - his agent provided he has been duly authorised by the principal; and

(viii) In case of dissolved partnership firm - any partner provided he has been duly authorised by all other ex-partners of the firm.

Issue of Refund

If the Assessing Officer is satisfied that the refund claim is complete and in order, he shall complete the assessment and issue a refund voucher payable at the Reserve Bank or the State Bank or any treasury. The refund voucher is encashable like any other cheque, within three months from the date of issue. If the assessee fails to encash it within the prescribed time (3 months from the date of issue), he should send it to the Assessing Officer who will cancel it and issue a fresh one. If the applicant is a resident and the amount of refund is small, the amount may be sent by money order at Government cost. Where the assessee is a non-resident, generally a Bank Draft is sent at his cost.

Adjustment of Refund

All refunds may not be settled by actual payments. Wherever it is found that tax for some other years (either earlier or subsequent to the year to which the refund relates) are outstanding against the assessee, the refund due may be adjusted against the outstanding demand and the balance, if any, refunded to him. However, the amount can be adjusted only after giving an intimation in writing to the assessee of the action proposed to be taken for the purpose.

Interest on Refunds

Section 244A, provides that where, in pursuance of any order passed under the Income-tax Act, refund of any amount becomes due to the assessee, he shall be entitled to receive, in addition to the said amount, simple interest thereon calculated in the following manner:

(a) Where the refund is out of any tax collected at source under Section 206C or paid by way of advance tax or treated as paid under Section 199, during the financial year immediately preceding the assessment year, interest calculated at the rate of one half per cent for every month or part of a month comprised in the period from 1st day of April of the assessment year to the date on which the refund is granted. But, if the amount of refunds is less than ten per cent of the tax as determined on regular assessment, no interest shall be payable.

However, no interest shall be payable if the amount of refund is less than ten percent of the tax as determined under Sub-section (1) of Section 143 or regular assessment.

(b) In any other case, such interest has to be calculated at the rate of one half per cent for every month or part of a month comprised in the period or periods from the date or dates of payment of the tax or penalty to the date on which the refund is granted (The "date of payment of tax or penalty" means the date on and from which the amount of tax or penalty; specified in the demand notice under Section 156 is paid in excess of such demand).

(c) The assessee is not entitled to any interest on refund where a delay in payment thereof takes place for reasons attributable to the assessee. Any question as to the period to be excluded has to be decided by the Chief Commissioner or Commissioner whose decision thereon shall be final.

(d) In the event of increase or reduction of the amount on which the interest is payable (as a consequence of an order 143(3); 144; 147; 154; 155; 250; 254; 260; 262; 263; 264; or 245D(4), interest payable is to be increased or reduced accordingly. In the case of subsequent reduction of the interest, the Assessing Officer has to serve a demand notice on the assessee requiring him to pay back such amount as has been paid in excess.

The provisions of this section shall apply in respect of assessments for the assessment year commencing on the 1st day of April, 1989 and subsequent years. However, in respect of assessment of fringe benefits, the provisions of this Sub-section shall have effect as if for the figures "1989", the figures "2006" had been substituted.

INTEREST FOR BELATED PAYMENT OF INCOME-TAX [Section 220(2)]

An assessee is liable to pay interest @ 1% for every month or part thereof comprised in the period intervening between the expiry of 30 days w.e.f. serving of the notice of demand and actual payment of tax for the delay in making the payment of tax demanded beyond 30 days from the date of receipt of the demand notice. Sub-section (2A) of Section 220, empowers the Board to reduce or waive the amount of interest payable by an assessee under the above section on the recommendation made by the Chief Commissioner or Commissioner in this behalf. The Board's order will be passed only upon satisfaction that:

(a) the payment of such interest has caused or would cause genuine hardship to the assessee;

(b) the default in the payment of the amount on which interest has been paid or was payable was due to circumstances beyond the control of the assessee; and

(c) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for recovery of any amount due from him.

INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME (Section 234A)

In cases where a return on income is furnished after the due date or is not furnished at all, the assessee has to pay simple interest at the rate of 1% per cent for every month or part of the month of default on the amount of tax on the total income as determined under sub-section (1) of Section 143, and where a regular assessment is made, on the amount of the tax or the total income determined under regular assessment or reduced by an amount of (1) advance tax if paid; (2) any TDS/TCS; (3) any relief under Sections 90, 90A; (4) any deduction under Sections 91; (5) any tax credit under the provisions of Section 115JAA.

The period for which the interest is payable commences from the date immediately following the due date for filing the return and ending on the date of furnishing of the return. Where the return is not furnished, the interest will be payable from the due date for filing the return till the date of completion of assessment.

INTEREST FOR DEFAULT IN PAYMENT OF ADVANCE TAX (Section 234B)

Where the assessee, liable to pay advance tax, has not remitted the same or Where the advance tax paid is less than 90 per cent of assessed tax He

has to pay simple interest on assessed tax means the tax on the total income determined under subsection(1) of section 143 and where a regular assessment is made, the tax on the total income determined under such regular assessment as reduced by the amount of (1) advance tax, if any paid; (2) any TDS/TCS; (3) any relief under Sections 90, 90A; (4) any deduction under Section 91; (5) any tax credit under provision of Section 115JAA @1% percent for every month or part of month from 1st day April next following such financial year to the date of determination of total income under section 143(1) and where a regular assessment is made,to the date of such regular assessment. .

In cases where the assessee has paid tax on the basis of self assessment under Section 140A, before the date of completion of a regular assessment, the interest is calculated on above basis upto the date of payment of tax under Section 140A and, the thereafter, on the amount by which the advance tax and tax paid under Section 140A fall short of advance tax. In the cases of enhancement or reduction of the amount on which interest was payable under Section 147 (income escaping assessment) or Section 153A;

Section 154 (rectification of mistake); Section 155 (other amendments on completed assessment of a partner in a firm; member of an AOP or body of individuals etc.); Section 250 (appeal); Section 254 (orders of the Appellate Tribunal); Section 260 (Decision of High Court or Supreme Court on the case stated; Section 262 (hearing before Supreme Court); Section 263 (revision of orders prejudicial to revenue); Section 264 (Revision of orders); or 245D(4) [order of the Settlement Commission, the interest shall be increased or reduced correspondingly. Where the interest has already been paid to the assessee, a notice of demand, calling for payment of such amount, has to be served on the assessee by the Assessing Officer. Such notice of demand shall be deemed to be an order under Section 156 of the Act.

INTEREST FOR DEFERMENT OF ADVANCE TAX (Section 234C)

If the assessee (non-corporate assessee)

If the assessee (non-corporate assessee) who is liable to pay advance tax under Section 208 has failed to pay such tax or has underestimated the instalments of advance tax, he has to pay interest as follows:

(i) If advance tax paid on or before 15 September is less than 30% of tax due on total income declared in the return filed by the assessee, the assessee shall pay simple interest @ 1% per month for a period of three months on the amount of the shortfall from thirty per cent of the tax due on the returned income.

(ii) If advance tax paid on or before 15 December is less than 60% of tax on total income declared in the return, the assessee shall pay simple interest @ 1% per month for a period of three months on the amount of the shortfall from sixty per cent of the tax due on the returned income.

(iii) If advance tax paid on or before March 15 is less than 100% of tax due on total income declared in the return, as reduced by tax deducted at source, simple interest is payable @ 1% per month on the amount of shortfall from the tax due on the returned income declared.

If the assessee (corporate assessee)

If the assessee (corporate assessee) who is liable to pay advance tax under Section 208 has failed to pay such tax or has underestimated the instalments of advance tax, he has to pay interest as follows:

(i) If advance tax paid on or before 15 June is less than 15% of tax due on total income declared in the return or If advance tax paid on or before 15 September is less than 45% of tax due on total income declared in the return filed by the assessee or If advance tax paid on or before 15 December is less than 75% of tax due on total income declared in the return the assessee shall pay simple interest @ 1% per month for a period of three months on the amount of the shortfall from 15%, 45%, and 75% of the tax due on the returned income.

(iii) If advance tax paid on or before March 15 is less than 100% of tax due on total income declared in the return, as reduced by tax deducted at source, simple interest is payable @ 1% per month on the amount of shortfall from the tax due on the returned income declared.

The following explanation shall be substituted w.e.f. 1.4.2007, namely:

"Explanation: in this section "tax due on the returned income" means the tax chargeable on the total income declared in the return of income furnished by the assessee for the assessment year commencing on the 1st day of April immediately following the financial year in which the advance tax is paid or payable, as reduced by the amount of,- (1) any TDS/TCS (2) any relief of tax under Section 90 or 90A (3) any deduction under Section 91 (4) any tax credit u/s 115JAA."

INTEREST RECEIVABLE BY THE ASSESSEE SECTION 244A (INTEREST ON REFUNDS)

(a) If the amount of refund is not less than ten per cent of the tax as determined on regular assessment, and the refund is out of any tax collected at source under Section 206C or treated as paid under Section 199, during the financial year immediately preceding the assessment year, interest shall be payable at the rate of 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.

Any payment of advance tax payable made before March 31 shall be treated as advance tax paid during the financial year. In case of public holiday or bank holiday, date of payment automatically falls in the next working day and for that delay, interest is not charged under Sections 234B and 234C vide Circular No. 676 dated 14.01.1994. Tax to be computed at the prevailing rate on the current income of the assessee, in a financial year.

REVIEW 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.
4. State the provisions regarding deduction of tax at source in respect of the following incomes:

(i) Rent

(ii) Professional or technical fees.

(iii) Winning from horse races.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

IMPORTANT NOTES

UNIT-11 PROCEDURE FOR ASSESSMENT

CONTENTS

- Income-Tax Authorities (Appointment, Jurisdiction and Powers)
- Appointment of Income-tax Authorities (Section 117)
- Control of Income-tax Authorities (Section 118)
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- Return of Income [(Section 139(1)]
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Digital Signature Certificate (DSC) is an electronic signature that can be used to authenticate the identity of the sender of a message or the signer of a document and it is equivalent of a hand written signature. An assessee can use a DSC to file their return/form.

INCOME-TAX AUTHORITIES (APPOINTMENT, JURISDICTION AND POWERS) (SECTION 116)

The following are the income-tax authorities who are statutorily empowered to administer the law of Income- tax:

(i) The Central Board of Direct Taxes, constituted under the Central Boards of Revenue Act, 1963;

(ii) Directors-General of Income-tax or Chief Commissioners of Income-tax;

(iii) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals);

(iv) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals);

(v) Joint Directors of Income tax or Joint Commissioners of Income-tax.

(vi) Deputy Directors of Income-tax or Deputy Commissioners of Income-tax or Deputy Commissioners of Income-tax (Appeals);

(vii) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax;

3.0 (viii) Income-tax (Assessing) Officers;

(ix) Tax Recovery Officers;

(x) Inspectors of Income-tax.

The provisions of the Income-tax Act contained in Sections 117 to 136 specify the procedure relating to the appointment of the various income-tax authorities, their powers, functions, jurisdiction and control. In addition to the various provisions contained in these sections, the Income-tax Department follows the system of functional allocation and distribution of work with a view to specialising and concentrating in the

various areas of Income tax assessment, procedure, collection, recovery, refund, appeals, etc.
For all purposes of the Income-tax Act, the Income Tax authorities are vested with the various powers which are
vested in a Court of Law under the Code of Civil Procedure while trying a suit in respect of any case. More particularly, the provisions of the Code of Civil Procedure and the powers granted to the tax authorities under the code would in respect of:
(a) discovery and inspection;
(b) enforcing the attendance, including any officer of a bank and examining him on oath;
(c) compelling the production of books of accounts and the documents;
(d) collecting certain information [Section 133B - inserted by the Finance Act, 1986];
(e) issuing commissions and summons.
The Finance Act, 1985 has added that w.e.f. 1.4.1973 every income-tax authority shall be deemed to be a Civil Court for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973. The powers granted are generally quasi-judicial. In particular, the powers of income-tax authorities relate to discovery, production of evidence etc., searches and seizures, application of retained assets, power to call for information from various parties, authorities and bodies, powers of survey, powers relating to the inspection of the registers of companies etc. Further, all proceedings under the Income-tax Act before any income-tax authority must be deemed to be judicial proceedings within the meaning of Sections 193 and 228 and for purposes of Section 196 of the Indian Penal Code. For a detailed Study of the various powers, functions, jurisdiction, etc., of the different
classes of income-tax authorities and the general scheme of administration of the Income-tax Act, students may refer to the relevant provisions of the Income-tax Act.

Appointment of Income-tax Authorities (Section 117)

The Central Government may appoint such persons as it thinks fit to be income-tax authorities. Where an income-tax authority is authorised by the Board, it may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its function.

Control of Income-tax Authorities (Section 118)

The Board is empowered to control the income-tax authorities. It may notify that any income-tax authority will be sub-ordinate to such other income-tax authority or authorities as may be specified in the notification.

THE CENTRAL BOARD OF DIRECT TAXES (CBDT)

Appointment and Working of the Board

The Central Board of Direct Taxes was created under the Central Boards of Revenue Act, 1963 [Section 2(12)]. The Board in its working is closely associated with the Ministry of Finance.

Jurisdiction

It is the topmost executive authority in the sphere of direct taxes. Its powers of administration supervision and control extend over the whole department.

Power

(i) **Power to make Rules**: It has the power to make rules (under Section 295) for carrying out the purposes of this Act. The Rules may be made for whole or any part of India.

(ii) **To issue instructions**: It may issue orders, instructions and directions to all officers and persons employed in the execution of the Act (Section 119). However, it cannot interfere with the discretion of the Commissioner (Appeals), in the exercise of the appellate functions [Section 119(1)(b)] and it cannot direct the Assessing Officer or any other income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner [J.K. Synthetics Ltd. v. CBDT (1972) 83 ITR 335 (SC)] [Section 119(1)(a)].

(iii) **Power to relax mandatory provisions**: The Board is empowered to relax the provision relating to the charge of mandatory interest for defaults in deduction of tax at source, or payment of such tax [under Section 201(1A)] or payment of advance tax (Section 211) or interest for defaults in furnishing return (Section 234A) or interest for defaults in payment of advance tax (under Section 234B or Section 234C) or assessment and recovery of tax.

The Board is also empowered to relax the provisions relating to the computation of total income and deductions to be made in computing total income in cases of genuine hardship. It can be done by a general or special order and for reasons to be specified therein.

(iv) **Power to admit belated refund application**: To avoid genuine hardship in any case or class of cases, the Board may authorise any income-tax authority, not being Commissioner (Appeals) to admit belated application or claim for any exemption, deduction, refund or any other relief [Section 119(2)(b)].

(v) **Power to decide jurisdiction**: The Board is empowered to decide jurisdictional matters of any Income tax authority and assign to them such functions as are to be performed by them (Section 120).

(vi) **Power to disclose information**: The Board may disclose information relating to any assessee, to any officer, authority, or body performing any functions under any tax law relating to the imposition of any tax, duty or cess or dealing in foreign exchange under Foreign Exchange Management Act, 1999, if it considers such disclosure in public interest. The Board may also authorise any other income-tax authority to disclose such information (Section 138). The provision is intended to facilitate exchange of information about tax evaders.

Director-General or Director of Income-tax

He has the following powers:

(a) **To appoint an income-tax authority below the rank of an Assistant Commissioner (Section 117)**:

If so authorised by the Central Government a Director-General or Director may appoint an income- tax authority below the rank of Assistant Commissioner.

(b) **To delegate the powers of Assessing Officer to Joint Commissioner (Section 120)**: Where Director- General or Director is so authorised by the Board, he may delegate the powers and functions of the Assessing Officer to Joint Commissioner.

(c) **To transfer cases (Section 127)**: The Director-General may transfer any case from one or more Assessing Officers subordinate to him to any other Assessing Officer also subordinate to him.

(d) **Enquiry into concealment [Section 131(1A)]**: If the Director-General or Director or Deputy Director or Assistant Director (w.e.f. 1.6.1988) has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, he is empowered to make any enquiry or investigation relating thereto notwithstanding that no proceedings with respect to such person or class of persons are pending before him [Section 131(1A)].

(e) **Search and seizure [Section 132(1)]**: Where the Director- General or Director or Chief Commissioner or Commissioner in consequence of information in his possession has reason to believe that (a) any person to whom notice has been issued in respect of discovery and inspection etc. [under Section 131(1)] or (b) any person to whom notice has been issued to produce accounts or documents [under Section 142(1)], has failed to do so far he is not likely to produce such accounts or documents, or (c) any person is in possession of undisclosed income or property, he is empowered [under Section 132(1)] to authorise any Deputy Director, Deputy Commissioner, Assistant Director (Assistant Commissioner w.e.f. 1.4.1989) or Assessing Officer to enter and search any building, place, vessel, vehicle or aircraft, where he has reason to suspect about their availability and seize any such books of accounts, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search.

(f) **To requisition books of account/Assets etc. (Section 132A)**: Where any books of account or documents have been taken into custody by any officer or authority under any other law (e.g. by Commissioner or Customs, Sales Tax Commissioner etc.) and the Director General or Director or the Chief Commissioner or Commissioner, in consequence of information in his possession, has reason to believe that (i) any person, required to produce such accounts/documents prior to their acquisition under any other law, has failed to do so, or (ii) such accounts or documents will be useful for any proceeding under income-tax law but such person would not produce them on their return by the officer or authority under any other law, or (iii) any assets represent income or property which has not been, or would not have been disclosed by any person from whose possession or control such assets have been taken into custody by any officer or authority under any other law, he may authorise any Deputy Director, Deputy Commissioner, Assistant Director, Assistant Commissioner or Income-tax Officer to require such officer or authority under any other law to deliver such books of account or documents or such assets to the requisitioning officer under income-tax law. On a requisition being made, such officer or authority under any other law is required to deliver such books of accounts or documents or assets to the requisitioning officer either forthwith or after such time when it is no longer necessary to retain them in his custody.

(g) **To make any enquiry (Section 135)**: The Director-General or Director is competent to make any enquiry under this Act.

Chief Commissioner or Commissioner of Income-tax

He has the following powers:

(i) **To appoint an income-tax authority below the rank of Assistant Commissioner (Section 117)**: If so authorised by the Central Government, a Chief Commissioner or Commissioner may appoint an income-tax authority below the rank of Assistant Commissioner.

(ii) **To delegate the powers of Assessing Officer to Deputy Commissioner (Section 120)**: Where Chief Commissioner or Commissioner is so authorised by the Board, he may delegate the powers and functions of the Assessing Officer to Joint Director or Joint Commissioner.

(iii) **To transfer case (Section 127)**: The Chief Commissioner or Commissioner is empowered to transfer any case from any Assessing Officers to any other Assessing Officer or Assessing Officers.

(iv) **Power regarding discovery, production of evidence etc. (Section 131)**: The Chief Commissioner or Commissioner has the same powers as are vested in a Court under the Code of Civil Procedure in respect of discovery and inspection, compelling production of books of accounts and other documents (relating to any period), issuing commissions enforcing the attendance of any person, including any officer of a banking company and examining him on oath. The Commissioner may impound or retain any books of accounts or other documents produced before him for such time as he thinks fit [Section 131(3)].Where such power is exercised by the Assessing Officer, he has to record reasons before impounding the books of accounts or documents. The Assessing Officer or Assistant Commissioner cannot retain the books of accounts/documents for a period exceeding 15 days without prior approval of the Chief Commissioner or Director-General or Commissioner [Section 131(3)].

(v) **Search and seizure (Section 132)**: Like Director-General or Director, the Chief Commissioner or Commissioner of Income-tax has also got the powers of search and seizure.

(vi) **To requisition books of accounts etc. (Section 132A)**: Like Director-General or Director of Income tax, the Chief Commissioner or Commissioner is also vested with the power to requisition books of accounts.

(vii) **Power of survey (Section 133A)**: An income-tax authority (i.e. Commissioner, Joint Commissioner, Deputy Commissioner, Director, Joint Director, Deputy Director, Assistant Director or an Assessing Officer) is empowered to enter any place, within the limits of the area assigned to him, where business is carried on or where any books of accounts/documents, cash, stocks or other valuable articles relating to business are kept. An income-tax authority may (a) place marks of identification on the books of accounts or other documents inspected by him and make or cause to be made extracts or copies therefrom, or (b) make an inventory of any cash, stock or other valuable articles or things checked or verified by him, or (c) record the statement of any person which may be useful or relevant to any proceeding under this Act. Books of accounts or other documents, any cash, stock or other valuable articles cannot be removed by the income-tax authority from such place. The

entry (a) to a business place should be made during the hours at which such place is open for the conduct of the business, and (b) to any other place only after sun rise and before sun set. An entry to a place not falling within the jurisdiction of an income-tax authority, should be made with the prior approval of that income-tax authority who exercises jurisdiction over that place.

Where an assessee incurs an ostentatious expenditure on any function, ceremony, the income-tax authority is empowered to collect information about such expenditure from the assessee or any other person who is likely to possess information in this connection and may record their statement which may be used thereafter as an evidence. This may be done at time such function or ceremony is over.

(viii) **To make any enquiry (Section 135)**: The Chief Commissioner or Commissioner is competent to make any enquiry under this Act.

(ix) **Disclosure of information respecting assessees (Section 138)**: Where a person makes an application to the Chief Commissioner or Commissioner in the prescribed form for any information relating to any assessee in respect of any assessment, he may furnish the information asked for in respect of that assessment if he satisfied that such disclosure is in public interest.

(x) **To sanction reopening of the assessment after the expiry of four years [Section 151(2)]**: The assessment of an income which has escaped assessment can be reopened after the expiry of four years from the end of the relevant assessment year only if the Chief Commissioner or Commissioner has sanctioned such reopening.

(xi) **To approve withholding of refund in certain cases (Section 241)**: Where any proceeding is pending against the assessees and the Assessing Officer is of the opinion that the grant of the refund may adversely affect the revenue, the Chief Commissioner or Commissioner may authorise the Assessing Officer to withhold the refund till such time as the Chief Commissioner or Commissioner may determine.

(xii) **Set-off of refund against arrears of tax (Section 245)**: The Chief Commissioner or Commissioner is empowered to set off the amount of refund or any part thereof due to any person against the arrears of the tax due from such person. Any intimation in writing to this effect should be given to such person.

(xiii) **To direct the Assessing Officer to prefer appeal to the Tribunal against A.A.C.'s order [Section 253(2)]**: The Commissioner may, if he objects to any order passed by a Commissioner (Appeals), direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

(xiv) **To revise any order passed by the Assessing Officer which is prejudicial to revenue (Section 263)**: The Commissioner may revise any order passed by the Assessing Officer which is prejudicial to the interest or revenue.

(xv) **Revision of any order passed by a subordinate authority on application by the assessee or suo motu (Section 264)**: The Commissioner may revise either on his own motion or on an application made by the assessee within the prescribed time for such revision, any order passed by an authority subordinate to him. He may pass such order thereon, not being an order prejudicial to the assessee as he may think fit.

Commissioner of Income-tax (Appeals)

The Commissioner of Income-tax (Appeals) is an appellate authority. It is vested with the judicial powers:

(1) **Power regarding discovery, production of evidence (Section 131)**: Like Chief Commissioner or Commissioner, the power regarding discovery, production of evidence etc., can also be exercised by the Commissioner (Appeals).

(2) **Power to call for information (Section 133)**: The Commissioner of Income-tax (Appeals) may, for the purposes of this Act:

(a) require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares;

(b) require any Hindu Undivided Family to furnish him with a return of the names and addresses of the manager and the members of the family;

(c) require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian or agent, and of their addresses;

(d) require any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity together with particulars of such such payments made;

(e) require any dealer, broker or agent or any person concerned in the management of a stock or Commodity Exchange to furnish a statement of the names and addresses of all persons to whom he or the Exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the Exchange has received any such sum, together with particulars of all such payments and receipts;

(f) require any person, including a banking company or any officer thereof, to furnish information in relation to such point or mater or to furnish statements of accounts and affairs verified in the specified manner, giving such information as may be required by him.

(3) **Power to inspect register of companies (Section 134)**: The Commissioner (Appeals) may inspect and, if necessary, take copies or cause copies to be taken, of any register of members, debenture holders or mortgagees of any company or of any entry in such register. The Commissioner (Appeals) may also authorize (in writing) any person subordinate to him to inspect and, if necessary, take copies or registers as aforesaid.

(4) **Set-off of refund against arrears of tax (Section 245)**: The Commissioner (Appeals) is empowered to set off the amount of refund or any part thereof due to any person against the arrears of tax due from such person. Intimation in writing to this effect should be given to such person.

(5) **Disposal of appeal (Section 251)**: In disposing of an appeal, the Commissioner (Appeals) has the following powers:

(a) in an appeal against an order of assessment he may confirm, reduce, enhance or annual the assessment, or he may set aside the assessment

and refer back to the Assessing Officer for making a fresh assessment in accordance with such directions as given by him.

(b) in an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or reduce the penalty.

(c) in any other case, he may pass such order in appeals as he thinks fit.

It may be noted that an assessment or a penalty cannot be enhanced or the amount of refund cannot be reduced unless the appellant had a reasonable opportunity of showing cause against such enhancement or reduction.

(6) **Imposition of penalty (Section 271)**: The Commissioner (Appeals) may impose penalty for not producing the books of accounts or other documents [Section 142(1)] or for concealment of income (under Section 271).

Jurisdiction of Income-tax Authorities (Section 120)

Income-tax authorities are required to exercise or perform such powers or functions as are assigned to them by the Board [Section 120(1)]. Any income-tax authority, being an authority higher in rank, may, if so directed by the Board exercise the powers and performs the functions of the income-tax authority lower in rank and any such direction issued by the Board shall be deemed to be a direction issued under Sub-section (1).

The Board may authorise any other income-tax authority to issue orders in writing for the exercise of the powers and performance of the functions by all or any of the income-tax authority who are subordinate to it [Section 120(2)]. While issuing such directions, the Board or any other income-tax authority authorised by it may take into account (i) territorial area, (ii) persons or classes of persons, (iii) incomes or classes of income, and (iv) cases or classes of cases [Section 120(3)].

RETURN OF INCOME [(SECTION 139(1)]

The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income. According to that section, it is statutorily obligatory for every person being a company or a firm or being a person other than a company or firm to furnish a return of his total income or the total income of any other person in respect of which he is assessable under the Income-tax Act, in all cases where his total income or the total income of any other person for which he is liable to be assessed exceeds, in any relevant accounting year, the maximum amount which is not chargeable to income-tax. The return of income must be furnished by the assessee in the prescribed manner by the Board from time to time.

It should be obligatory for the firm to file return of income in every case. Further, in respect of individual, HUF, AOP, BOI, Artificial juridical Person, filing of return of income shall be compulsory if their total income before

allowing deductions under Sections 10A, 10B,10BA or chapter VI-A exceeds the maximum amount which is not chargeable to income tax.

Compulsory filing of Income Tax return in relation to assets located outside India

From assessment year 2012-13, it is mandatory to file a return of income where a person, being a resident other than not ordinarily resident in India and who during the previous year has any asset (including any financial interest in any entity) located outside India or signing authority in any account located outside India. In such a case, it is immaterial that the taxable income is less than the maximum amount not chargeable to tax.

Exemption from filing of Return of Income

CBDT has clarified vide Press Release [No. 402/92/2006-MC (15 of 2012)], dated 20-7-2012 that under what conditions exemption from filing of return is available.

Exemption is available to salaried employees from the requirement of filing the returns for A.Y. 2012-13. The exemption is applicable only if all the following conditions are fulfilled: -

• Employee has earned only salary income and income from savings bank account and the annual interest earned from savings bank account is less than `10 thousand.

• The total Income of the employee does not exceed ` 5 Lakh (Total Income means Gross Total Income Less deductions under Chapter VIA).

• The Employee has reported his PAN to the employer.

• Employee has reported his income from interest on savings bank account to employer.

• Employee has received Form 16 from his employer.

• Total Tax Liability of employee has been paid off by employer by way of TDS and employer has deposited TDS with central government.

• Employee has no refund claim.

• Employee has received salary only from one employer.

• Employee has not received any Notice from Income Tax Department for filing of Income Tax return.

Due date for filing return of income

The assessee is obliged to voluntarily file the return of income without waiting for the notice of the Assessing Officer calling for the filing of the return.

The time limit for filing of the return by an assessee if his total income of any other person in respect of which he is assessable exceeds the maximum amount not chargeable to tax, shall be as follows:

(a) where the assessee is –

(i) a company,

(ii) a person, other than a company whose accounts are required to be audited under the Income-tax Act or any other law, for the time being in force,

(iii) a working partner of a firm whose accounts are required to be audited under this Act or under any
law for the time being in force, the 30th day of September of the Assessment Year.

(b) In the case of an assessee being a company, which is required to furnish a report referred to in section 92E, the 30th day of November of the assessment year.
(c) in the case of any other assessee, the 31st day of July of the Assessment Year.

E-filing of Return

Filing of Income Tax Returns is a legal obligation of every person who total for the previous year exceeds the exemption limit provided under the Income Tax Act, 1961. The Income Tax Department has introduced on line facility in addition to conventional method to file return of income. The process of electronically filing of Income Tax return through the mode of internet access is called e-filing of return. E-filing offers convenience of the tax payers. The only obligation for the user of this facility is to have a PAN number. There are eight forms from ITRI to ITR-8 for e-filing of returns. There is a provision e-filing for digital signature by the assessee.

Bulk Filing of Return

Finance Act, 2002 has introduced a new scheme of Bulk Filing of Return vide new Section 139(1A). According to the new provisions, any person, being an individual who is in receipt of income chargeable under the head "Salaries" may, at his option, furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be specified by the Board in this behalf. The employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme, and in such case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under Section 139(1) and the provisions of this Act shall apply accordingly. However, the following returns of employees cannot be submitted under the above schemes:

I. return of a year other than the current year;
II. return without PAN;
III. return under Block assessment;
IV. return of an employee having more than one employer.

Power to Central Government

Section 139(1C) empower the Central Government to exempt any class or classes of persons from the requirement of furnishing a return of income by issue notification in the Official Gazette.

RETURN OF LOSS- SECTION 139(3)

The requirements of Income-tax Act making it obligatory for the assessee to file a return of his total income even in cases where the assessee has incurred a loss under the head 'profits and gains from business or profession' or loss from maintenance of race horses or under the head 'Capital gains'. Unless the assessee files a return of loss in the manner and within the same time limits as required for a return of income, the assessee would not be entitled to carry forward the loss for being set off against income in the subsequent year.

BELATED RETURN – SECTION 139(4)

Any person who has not filed the return within the time allowed under section 139(1) or within the time allowed
under a notice issued by the Assessing Officer under section 142(1) may file a belated return – at any time before the expiry of one year from the end of the relevant assessment year or

– before the completion of the assessment whichever is earlier.

RETURN OF INCOME OF CHARITABLE TRUST AND INSTITUTIONS – SECTION 139(4A)

Sub-section (4A) of Section 139 also makes it incumbent of "every person in receipt of income derived from property held under trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes or of income being voluntary contributions within the meaning of Section 2(24)(iia)" to furnish a return of income in case the total income exceeds the maximum amount not chargeable to tax. Further, one who is assessable as a representative assessee for the receipt of income derived from property held under Trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes or of income being voluntary contributions shall furnish a return of income of the previous year in the prescribed form and get it verified in such manner as prescribed under Section 139(1), if the total income (without giving effect to the provisions of Sections 11 and 12) exceeds the amount not chargeable to tax.

RETURN OF INCOME OF POLITICAL PARTY- SECTION 139(4B)

It is also incumbent on the political parties to file their return of income [if the income (without giving effect to the provisions of Section 13A) exceeds the maximum amount not chargeable to tax], duly signed by the Chief Executive Officer of the party

RETURN OF INCOME OF SPECIFIED ASSOCIATION/INSTITUTIONS- SECTION 139(4C)

Before introducing a new Section 139(4C) to the Act, there was an ambiguity about filing of return by certain categories of persons who are availing the exemption from income tax. Now this issue is solved with effect from
assessment year 2003-04 and the following persons are required to file the return:

(a) Research association referred to in Section 10(21);
(b) news agency referred to in Section 10(22B);
(c) association or institution referred to in Section 10(23A);
(d) institution referred to in Section 10(23B);
(e) fund or institution referred to in Section 10(23C)(iv), (v), (vi) or (via);
(f) trade union referred to in Section 10(24)(a) or 10(24)(b),
(g) body or authority or Board or Trust or Commission in section 10(46)
(h) infrastructure debt fund referred to in section 10(47)

The above persons shall, if the total income, without giving effect to the provisions of Section 10, exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and verified in the prescribed manner and

setting forth such other particulars as may be prescribed and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under Section 139(1)".

REVISED RETURN- SECTION 139(5)

An assessee who is required to file a return of income is entitled to revise the return of income originally filed by him to make such amendments, additions or changes as may be found necessary by him. Such a revised return may be filed by the assessee at any time

– before the expiry of one year from the end of the relevant assessment year

– before the the completion of assessment

whichever is earlier.

DEFECTIVE RETURN-SECTION 139(9)

If the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within 15 days from the date of such intimation or within such further period as may be allowed by the Assessing Officer on the request of the assessee. If the assessee fails to rectify the defect within the aforesaid period, the return shall be deemed to be invalid and further it shall be deemed that the assessee had failed to furnish the return. However, where the assessee rectifies the defect after the expiry of the aforesaid period but before the assessment is made, the Assessing Officer may condone the delay and treat the return as a valid return.

If the self assessment tax is not paid on or before the date of furnishing the return of income, return shall be considered as defective return. A return of income shall be regarded as a defective return unless all the following conditions are fulfilled:

(a) the annexures, statements and columns in the return of income relating to computation of income chargeable under each head of income, computation of gross total income and total income have been duly filled in;

(b) the return is accompanied by a statement showing the computation of tax payable on the basis of return as well as the report of audit obtained under Section 4AB;

(c) the return is accompanied by proof of:

(i) the tax, if any, claimed to have deducted at source and the advance tax and tax on self-assessment, if any, claimed to have been paid;

(ii) the amount of compulsory deposit, if any, claimed to have been made (The scheme has been abolished w.e.f. 1.4.1985). But a return shall not be called defective where it is not accompanied by proof of the tax, if any, claimed to have been deducted at source, if:

(a) a certificate for tax deducted was not furnished under Section 203 to the person furnishing his return of income;

(b) such certificate is produced within a period of two years specified under Sub-section (14) of Section 155".

(d) where the regular books of account are maintained by the assessee, the return is accompanied by copies of:

(i) manufacturing account, trading account, profit and loss account or income and expenditure account or any similar account and balance sheet;

(ii) in the case of proprietary business or profession, the personal account of the proprietor; in the case of a firm, association of persons or body of individuals, personal accounts of the partners or members; and in the case of a partner or member of a firm, association of persons or body of individuals, also his personal account in the firm, association of persons or body of individuals.

(e) where the accounts of the assessee have been audited, the return is accompanied by copies of the audited profit and loss account and balance sheet and auditors' report; and where an audit of cost accounts of the assessees has been conducted under Section 233B of the Companies Act, 1956 also the report under that section.

(f) where regular accounts are not maintained by the assessee, the return is accompanied by a statement indicating the amounts of turnover or gross receipts, gross profit, expenses and net profit of the business or profession and the basis of which such amounts have been computed, and also disclosing the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

Note: Not relevant now as the assessee has to furnish annexure less return of income from assessment year 2007-08 and onwards.

NEW SCHEME TO FACILITATE SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B] [W.E.F. 1-6-2006]

W.e.f. 1.6.2006, a new section 139B have been inserted in the Act so as to provide that for the purpose of enabling any specified class or classes of persons to prepare and furnish returns of income, the Board may, by way of notification, frame a scheme providing that such persons may furnish their returns of income through a Tax return preparer authorized to act as such under the scheme. This scheme is not applicable for a company or a person who is required to undergo a 'tax audit' or 'audit under any other law'.

It has been further provided that the Scheme framed under the said section shall specify the manner in which the Tax return preparer shall assist the persons furnishing the return of income, and shall also affix his signature on such return.

A Tax return preparer may be an individual other than a person referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (2) of section 288 or an employee of the specified class or classes of persons, who has been authorized to act as a Tax return preparer under this Scheme. In other words, the following persons are not authorized to act as Tax return preparer:

– any officer of a scheduled bank in which the assessee maintains a current account or has regular dealings.

– A legal practitioner; or

– A chartered accountant.

The Scheme notified under the said section shall provide the manner in which a Tax return preparer shall be authorized, the educational and other qualifications to be possessed, and the training and other conditions

required to be fulfilled, by a person to act as a Tax return preparer, the code of conduct for the Tax return preparer, the duties and obligations of the Tax return preparer, the manner in which the authorization may be withdrawn and any other matter which is required to be or may be specified.

SIGNING OF RETURN (SECTION 140)

The return of income must be signed and verified:

(a) In the case of an individual,

(i) by the individual himself;

(ii) where he is absent from India, by the individual himself or by some person duly authorised by him in this behalf;

(iii) where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf; and

(iv) where, for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf: Provided that in a case referred to in Sub-clause (ii) or (iv), the person signing the return holds a valid power of attorney from the individual to do so, which shall be attached to the return:

(b) in the case of a H.U.F. by the Karta, and, where the karta is absent from India or mentally incapacitated
from attending to his affairs, by any other adult member of such family;

(c) in the case of a local authority, the Principal Officer thereof;

(d) in the case of a firm, by managing partner thereof or where for any unavoidable circumstances such managing partner is not able to signand 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 forany unavoidable reason such designated partner is not able to sign and verify the return, or wherethere is no designated partner as such, by any partner.

(f) in the case of any other association, by any member of the association or Principal Officer thereof;

(g) in the case of any other person, by that person or some person competent to act on his behalf;

(h) in the case of a company; by the managing director thereof, or where for any unavoidable reason such managing director is not able to sign the return or where there is no managing director, by any director thereof.

Provided that where the company is not resident in India, the return may be signed and verified by a person who holds a valid power of attorney from such company to do so, which shall be attached to the return:

Provided further that –

(a) where the company is being wound up, whether under the order of a court or otherwise, or where any person has been appointed as the receiver of any assets of the company, the return shall be signed and verified by the liquidator referred to in Sub-section (1) of Section 178;

(b) where the management of the company has been taken over by the Central Government or any State Government under any law, the return of the company shall be signed and verified by the Principal Officer thereof;

(i) in the case of a political party referred-to in Sub-section (4B) of Section 139, by the Chief Executive
Officer of such party whether such Chief Executive Officer is known as secretary or by any other designation.

PERMANENT ACCOUNT NUMBER (SECTION 139A)

Every person, who has not been allotted any permanent account number, is obliged to obtain permanent account
number, if;

– if his total income assessable during the previous year exceeds the maximum amount which is not chargeable to tax or

– any person carrying on business or profession whose total sales turnover or gross receipts are or is likely to exceed `5,00,000 in any previous year or

– is required to furnish a return of income under Section 139(4A)

Besides above cases, the Assessing Officer may also allot a permanent account number to any other person by whom tax is payable. Any other person may also apply for a permanent account number. However, Section 139 has been amended w.e.f. August 1, 1998 and provides the alternative of quoting GIR (General Index Register) number till such time the permanent account number is allotted.

POWER DELEGATED TO CENTRAL GOVERNMENT

The Central Government may, by notification in the Official Gazette, specify, any class or classes of persons by whom tax is payable under this Act or any tax or duty is payable under any other law for the time being in force including importers and exporters whether any tax is payable by them or not and such persons shall, within such time as mentioned in that notification, apply to the Assessing Officer for the allotment of a permanent account number.

QUOTING OF PAN

It shall be the duty of every person who has been allotted permanent account number to quote such number in all his returns or correspondence with Income tax authorities, quote such numbers in all challans for the payment of any sum, quote such number in all documents pertaining to such transactions as may be prescribed by the Board in the interest of revenue.

Now quoting PAN is compulsory in the following transactions:

(a) Sale/purchase of any immovable property valued at ` 5 lakhs or more.

(b) Sale/Purchase of Motor vehicle or a vehicle (excluding two wheeled vehicle, inclusive of any detachable
side-car having an extra wheel) which requires registration under Motor Vehicles Act, 1988.

(c) Time deposit exceeding ` 50,000 with a Bank/Banking Company/Banking Institution.

(d) Deposit exceeding ` 50,000 in Post Office Savings Bank.

(e) Contract for sale/purchase of securities exceeding ` 1 lakh.

(f) Opening an account [not being time deposit mentioned in (c)] with a Bank/Banking Company/Banking Institution.

(g) Application for installation of a telephone connection including mobile phone.

(h) Payments to hotels of bills exceeding ` 25,000/- at any one time.

(i) Payment in cash for purchase of bank drafts or pay orders or banker's cheque for an amount of `
50,000 or more during any one day.
(j) Deposit in cash aggregating `50,000 during any one day.
(k) Payment in cash in connection with travel to any foreign country of an amount exceeding `25,000 at any one time.
(l) Making an application to any banking company or to any other company or institution for issue of a credit or debit card.
(m) Payment of an amount of `50,000 or more to a Mutual Fund for purchase of its units.
(n) Payment of `50,000 or more to a company for acquiring shares or debentures or bonds issued by it.
(o) Payment of `50,000 or more to RBI for acquiring bonds issued by it.
(p) Payment of an amount of `50,000 or more as life insurance premium to an insurer.
(r) Payment to a dealer
(i) of an amount of `5 lakh or more at any one time, or
(ii) against a bill for an amount of `5 lakh or more for purchase of bullion or jwellery.
Every person, receiving any document relating to the prescribed transactions, shall ensure that the permanent account number has been duly quoted in the document. The Board has been empowered to make rules in relation to the form and the manner in which the application for the allotment of a permanent account number and the particulars which such application will contain, prescribing the categories of transactions and the categories of documents pertaining to business or profession in which the permanent account numbers shall have to be quoted by every person.
The "permanent account number under the new series" has been defined to mean a number which will have ten alphanumeric characters to be issued on a laminated card. The expression "Assessing Officer" has been defined to include an income tax authority to whom the job of allotting permanent account numbers has been assigned.

TYPES OF ASSESSMENT

(a) Self assessment (Section 140A)
(b) Regular assessment (Section 143)
(c) Best judgement assessment (Section 144)
(d) Income escaping assessment or re-assessment (Section 147)
(e) Precautionary assessment.

(A) SELF ASSESSMENT (SECTION 140A)

Self assessment is the first step in the process of assessments. Self Assessment is simply a process where a person himself assesses his tax liability on the income earned during the particular previous year and submits Income Tax Return to the department. Every person, before furnishing return under sections 139(return of income), 142(1), 148 (issue of notice where income has escaped assessment) and 153A (Assessment in case of search or requisition) shall make self assessment of his income and pay the tax, if due on the basis of such assessment. The total tax payable is calculated on the total income of the assessee after considering the following amount:

(i) the amount of tax already paid under any provision of this Act;
(ii) any tax deducted or collected at source;
(iii) any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India;
(iv) any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section; and
(v) any tax credit claimed to be set off in accordance with the provisions of section 115JAA.

Such determined value of tax along with the interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax is paid before furnishing the return and the proof of payment of such tax is attached with the return. The work of income tax department became easy due to the system of Self Assessment.

INQUIRY BEFORE ASSESSMENT UNDER SECTION 142 OR 142A

1. Issue of notice to the assessee to submit return(if not submitted earlier):

The existing provisions contained in section 142(1)(i), inter alia, provide that for the purpose of making assessment in a case where a person has not made a return of his income within the time specified under sub-section (1) of section 139, the Assessing Officer may serve a notice under sub-section on such a person requiring him to furnish the return of his income in the prescribed form and manner.

Clause (i) of sub-section (1) has been amended so as to provide that in a case where a person has not made a return of his income before the end of the relevant assessment year, the Assessing Officer may serve a notice after the end of the relevant assessment year under said sub-section requiring such person to furnish his return of income.

The Assessing Officer may ask to produce, or cause to be produced, such accounts or documents and to furnish in writing and verified in the prescribed manner information in such form and on such points or matters (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not). However, the previous approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts. Futher, the Assessing Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

2. Make Inquiry and give opportunity of being heard u/s 142(2):

For the purpose of obtaining full information in respect of the income or loss of any person, the Assessing Officer may make such inquiry as he considers necessary

3. Give direction to get books of accounts audited u/s 142(2A) to (2D):

Having regard to the nature and complexity of the accounts volume of the accounts, doubts about the correctness of the accounts, multiplicity of transaction in the accounts or specialised nature of Business activity of the assessee and the interests of the revenue, assessing officer is of the opinion that it is necessary to order audit then with the previous approval

of the Chief Commissioner or Commissioner the Assessing Officer may direct
an assessee to get his accounts audited by an accountant even if the accounts have earlier been audited.
The Assessing Officer shall not direct the assessee to get the accounts audited unless the assessee has been given a reasonable opportunity of being heard.
Every report under sub-section (2A) shall be furnished by the assessee to the Assessing Officer within the period as specified by the Assessing Officer.
However, the Assessing Officer may, suo motu, or on an application made in this behalf by the assessee and for any good and sufficient reason, extend the said period by such further period or periods as he thinks fit but shall not exceed 180 days from the date on which the direction under sub-section (2A) is received by the assessee. The expenses of, and incidental to, such audit (including the remuneration of the Accountant) shall be determined by the Chief Commissioner or Commissioner in accordance with such guidelines as may be prescribed and the expenses so determined shall be paid by the Central Government.

Summary assessment/Intimation to the assessee u/s 143(1)

Under summary assessment, Assessing Officer completes the assessment without passing a regular assessment order. The Assessing Officer issue an acknowledgement/intimation under section 143(1) of tax payable or refundable as the case may be on the basis of Return of Income filed by the assessee under section 139 or in response to a notice issued under section 142(1). The Assessing Officer (AO) processes the return in the following manner:

(1) The total income or loss after making adjustments for any arithmetical error in the return or for any incorrect claim which is apparent from any information in the return is calculated.

(2) Then the tax and interest, if any, on the basis of the total income computed in step (1) is computed.

(3) Now following adjustments are made to the tax and interest calculated above to determine the sum payable by the assessee or any amount of refund due to him:

– tax deducted at source,
– any tax collected at source,
– any advance tax paid,
– any relief allowable under an agreement under section 90, 90A and 91,
– any rebate allowable under Part A of Chapter VIII,
– any tax paid on self-assessment and
– any amount paid otherwise by way of tax or interest;

(4) The AO shall prepare or generate intimation and send it to the assessee specifying the sum determined to be payable by, or the amount of refund due to the assessee.

(5) The amount of refund due to the assessee shall be granted to the assessee.

Since no assessment order is issued by the department for legal purposes the intimation/acknowledgement shall not be considered as assessment.
Time limit for intimation under section 143(1):

No intimation for tax or interest due under section 143(1) shall be sent after the expiry of 1 year from the end of
financial year in which return of income is made.

(b) SCRUTINY (REGULAR) ASSESSMENT [SECTION 143(2) & (3)]

Where a return has been made under Section 139, or in response to a notice under Sub-section (1) of Section 142, the Assessing Officer shall, if he considers necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return:
Provided that no notice under this sub-section shall be served on the assessee after the expiry of six months from the end of the Financial year in which the return is furnished. On the day specified in the notice issued under Sub-section (2), or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.

(c) BEST JUDGEMENT ASSESSMENT U/S 144

The Assessing Officer, after taking into account all relevant material which he has gathered, and after giving the assessee an opportunity of being heard, makes the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment in the following cases:
– If any person fails to make the return required under section 139(1) and has not made a return or a revised return under section 139(4) or 139(5), or
– When a person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited, or
– If any person having made a return, fails to comply with all the terms of a notice issued under section 143(2).
Prior to the proceedings the AO should issue a show cause notice to the assessee. However if the assessee has already issued notice under section 142(1)(i) and the assessee has not complied with the terms then AO can proceed further without issuing a show cause notice.
Further AO cannot assess the income below returned income and cannot assess losses higher than the returned losses. A refund cannot be granted under section 144.
The assessing officer can also reject the accounts book under section 145 and can make best judgment assessment under section 144 if:
– The accounts books are incorrect, false or incomplete.
– If the accounting method employed is such that the profit cannot be derived from it correctly.

– Where the method of accounting adopted by the assessee is not followed by him regularly.
– If the assessee has not followed the accounting standards notified by the government.
Note : From 1st day of April, 2014 section 144BA shall be omitted.

(d) INCOME ESCAPING ASSESSMENT OR RE-ASSESSMENT (SECTION 147)

If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, – assess or reassess income which has escaped assessment or – recompute the loss or the depreciation allowance or any other allowance, as the case may be for the relevant assessment year.

Section 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish, within such period, as may be specified in the notice, a return of his income or the income of any other person in respect of which he is assessable under this Act during the previous year corresponding to the relevant assessment year, in the prescribed form, and verified in the prescribed manner and setting forth such other particulars, as may be prescribed; and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return furnished as per the requirements of Section 139.

Provided that in a case

(a) where a return has been furnished during the period commencing on the 1st day of October, 1991 and ending on the 30th day of September, 2005 in response to a notice served under this section, and

(b) subsequently a notice has been served under Sub-section (2) of Section 143 after the expiry of twelve months specified in the proviso to Sub-section (2) of Section 143, as it stood immediately before the expiry of the time limit for making the assessment, reassessment or re-computation as specified in subsection (2) of Section 153, every such notice referred to in this clause shall be deemed to be a valid notice.

The following shall also be deemed to be cases where income chargeable to tax has escaped assessment, namely :

(i) where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax

(ii) where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return

(iii) where the assessee has failed to furnish a report in respect of any international transaction which he was so required under section 92E

(iv) where an assessment has been made, but

(i) income chargeable to tax has been under assessed ; or

(ii) such income has been assessed at too low a rate ; or

(iii) such income has been made the subject of excessive relief under this Act ; or

(iv) excessive loss or depreciation allowance or any other allowance under this Act has been computed;]
(v) where a person is found to have any asset (including financial interest in any entity) located outside India.
The assessing officer before making the assessment under this section will have to issue notice u/s 148 to the assessee requiring him to file the return even if he has already filed the return under section 139 or 142(1). The AO is duty bound to provide the assessee the reasons recorded by him, if the assessee request for it. If on request the reasons are not supplied then AO cannot proceed the assessment. The time limit for issue of notice under section 148 is as under:

However, the time lime of 6 years is not sufficient in cases where assets are located outside India because gathering information regarding such assets takes much more time on account of additional procedures and laws of foreign jurisdictions. Therefore, the time limit for issue of notice for reopening an assessment has been increased to 16 years, where the income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment.

TIME LIMIT FOR COMPLETION OF ASSESSMENTS AND REASSESEMENTS (SECTION 153)

(1) Section 153(1) deals with time limit for completion of Assessment/Re-Assessment made under section 143 and 144:
When Assessment is made for the Assessment year 2010-11 or any Subsequent Assessment year, time limit for completion of such Assessment is **2 years** from the end of the relevant Assessment Year in which income was first assessable. However, where reference has been made to Transfer Pricing officer under section 92CA(1) during the course of proceeding for the assessment of total income such period for completion of assessment shall be 3 years.
(2) Section 153(2) deals with time limit for completion of Assessment/Re-Assessment under section 147 (Income Escaping Assessment):
The time limit for completion of Assessment/Re-Assessment is 1 year from end of the Financial Year in which notice under section 148 was served on the Assessee. Where reference is made to the Transfer Pricing officer under section 92CA(1) during the course of proceeding such period shall be 2 years for completion of assessment.
(3) Section 153(2A) deals with assessment where original assessment has been cancelled or set aside by the Appellate Authority under section 250 (Procedure in hearing), 254 (Order of Appelate Tribunal) or by Commissioner of Income Tax under section 263 (Revision of Orders, Prejudicial to Revenue), 264 (Revision of Orders in favour of Assessee):
The Time limit for completion of Assessment/Re-Assessment is 1 year from end of the Financial Year in which (a) Such order of set aside or cancelling the order is passed by the Appellate Authority under section 250 or 254 received by commissioner of Income Tax.
(b) Order under section 263 or 264 was passed by the Commissioner of Income Tax.

However, if reference was made to Transfer Pricing Officer under section 92CA(1) during the course of proceeding such period shall be 2 years for completion of assessment.

Note : The Commissioner (Appeals) cannot cancel or set aside the Assessment and refer the case to the Assessing Officer for fresh assessment. However, it can be set aside by ITAT or Commissioner under section 263 or 264.

(4) Section 153(4) deals with the cases where any Proceeding initiated or order of assessment/re-assessment made under 153A(1) [relating to assessment of search cases] has been annulled in an appeal or in other legal proceedings and assessment/re-assessment relating to assessment year which was abaited has been revived:

In such case the time limit for completion of Assessment/Re-Assessment is 1 year **from end of the month** of such revival or within the time specified in section 153 or section 153B(1) [prescribe time limit for completion of assessment under section 153A] whichever is **later.**

Computation of Period of limitation

In computing the period of limitation for this purpose, the time taken in the following cases shall be excluded: (i) the time taken in re-opening the whole or part of the proceeding or in giving an opportunity to the assessee to be re-heard under section 129;

(ii) the period during which the assessment proceeding is stayed by an order or injunction of any court;

(iii) the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A) and ending with the last date on which the assessee is required to furnish a report of such audit or where such direction is challenged before a court, ending with the date on which order is setting aside the date on which such direction is received by the commissioner;

(iv) the period (not exceeding 60 days) commencing from the date on which the declaration under Section 158A(1) is received by the Assessing Officer and ending with the date on which the order there under is made by him;

(v) where an application made before the Income-tax Settlement Commission is rejected by it, the period commencing from the date on which application is made and ending with the date on which the order is received by the Chief Commissioner or Commissioner.

(vi) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) of section 245Q and ending with the date on which the order rejecting the application is received by the Commissioner under sub-section (3) of section 245R, or

(vii) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) of section 245Q and ending with the date on which the advance ruling pronounced by it is received by the Commissioner under sub-section (7) of section 245R; or (viii) the period commencing from the date on which reference or first of the refrences for the exchange of information is made by the authority competent under an agreement referred to in section 90

or section 90A and ending with the date on which the information requested is last received by the commissioner
or a period of one year whichever is less; or

(e) Precautionary Assessment

Where it is not clear as to who has received the income and prima facie, it appears that the income may have been received either by A or by B or by both together, the Assessing Officer can commence proceedings against
both A and B to determine the question as to who is responsible to pay the tax [Lalji Haridas v. I.T.O. (1961) 43
ITR p. 387 (S.C.)].

REFERENCE TO DISPUTE RESOLUTION PANEL (SECTION 144C)

The Assessing Officer shall, forward a draft order of assessment to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee. On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order.

(a) file his acceptance to the Assessing Officer, or
(b) file his objections with
(i) the Dispute Resolution Panel; and
(ii) the Assessing Officer

The Assessing Officer shall complete the assessment on the basis of the draft order, if the assessee intimates to the Assessing Officer the acceptance of the variation or no objections are received. The Assessing Officer shall, notwithstanding anything contained in section 153, pass the assessment order under sub-section (3) within one month from the end of the month in which the acceptance is received or the period of filing of objections expires. The Dispute Resolution Panel shall, in a case where any objection is received, issue such directions for the guidance of the Assessing Officer to enable him to complete the assessment.

The Dispute Resolution Panel shall issue the directions after considering draft order, objections filed by the assessee, evidence furnished by the assessee, report of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority, records relating to the draft order, evidence collected by it and result of any enquiry made by it.

The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order however it shal not set aside any proposed variation or issue any direction for further enquiry and passing of the assessment order.

If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer. No direction shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue. No direction shall be issued after

nine months from the end of the month in which the draft order is forwarded to the eligible assessee.
Upon receipt of the directions the Assessing Officer shall complete, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received.
1. "Dispute Resolution Panel" means a collegium comprising of three Commissioners of Income-tax constituted by the Board for this purpose;
2. "Eligible assessee" means
(i) any person in which case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 93CA; and
(ii) any foreign company.

ASSESSMENT IN CASE OF SEARCH OR REQUISITION (SECTION 153A)

Notwithstanding anything contained in sections 139, 147, 148, 149, 151 and 153 in case of a person where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A after 31.05.2003 the Assessing Officer shall assesses or reassesses the total income of six assessment years immediately proceeding the assessment years relevant to the previous year in which such search is conducted or requisition is made.

(A) Notice for filing return [Section 153A(1)(a)]

The Assessing Officer shall issue a notice for furnishing of return of income within the specified period in the notice for six assessment year in the prescribed format.

(B) Separate assessment for six assessment year

The Assessing Officer shall assess or reassess the total income of each of such six assessment year [Proviso 1 to section 153(1)].

(i) Time limit of completion of Assessment of 6 Assessment years [Section 153B(1)(a)] The Assessing officer shall make an order of assessment or re-assessment in respect of each assessment year falling within six assessment years under section 153A [Assessment in case of search or requisition] within a period of 2 years from the end of the financial year in which the last of the authorization for search under section 132 [search and seizure] or for requisition under section 132A [Powers to requisition books of accounts] was executed.
Where the search was executed on or after 1/4/2009 and during the course of proceedings for the assessment or re-assessment, a reference under section 92CA(1) the period for making an order of assessment or reassessment in respect of each assessment year shall be 3 years instead of 2 years as in normal case above.

(ii) Time limit of completion of assessment year relevant to the previous year in which search is conducted or requisition is made [Section 153(1)(b)]

The Time limit of completion of Assessment in respect of the assessment year 2010-11 & subsequent assessment year relevant to the previous year in which the search is conducted under section 132 or requisition is made under section 132A shall be a period of 3 years w.e.f. 1/7/2012 in case a reference is made under section

92CA(1) to Transfer Pricing officer from the end of the financial year in which the last of the authorization for search under section 132 or for requisition under section 132A, as the case may be was executed.

RECTIFICATION OF MISTAKES [Section 154]

With a view to rectifying any mistakes apparent from the record, an income-tax authority referred to in Section
116 may amend – any order passed by it under provisions of this Act or
– any intimation or deemed intimation under Section 143(1). This power of rectification can be exercised by the authorities either on their own motion or at the instance of the assessee.

Mistake which can be rectified

The mistake sought to be rectified may be a mistake of fact or of law. But the mistake must be one which is glaring, obvious or apparent from the records and should not be one to discover which a long drawn process of reasoning, arguments, etc., are needed, or for which there may be conceivably two opinions. A decision on debatable point of law is not a mistake apparent from the record [T. S. Balram v. Volkart Bros. (1971) 82 ITR p. 50 (S.C.)]. However, 'the record' contemplated under Section 154 does not mean only the order of assessment but it comprises all proceedings on which the assessment order is based. The relevant authority is entitled to look into the whole evidence and the law applicable to ascertain whether there was an error [Moharana Mills Pvt. Ltd. v. ITO (1959) 36 ITR p. 350 (S.C.)]. The power of rectification of mistake lies with the authority who passed the order which is sought to be rectified. For instance, the Assessing Officer may amend any order of assessment or refund or any other order passed by him. Likewise, the Deputy Commissioner or Commissioner (Appeals) or the Chief Commissioner or Commissioner may rectify any order passed by him.

Where an order of rectification of assessment has the effect of enhancing the amount of income assessed or reducing a refund granted to the assessee or in any way otherwise increasing the liability of the assessee, the order of rectification can be passed only after giving the assessee a notice in advance and, that too, after giving him a reasonable opportunity of being heard. Every order of rectification of assessment must be passed by the authority concerned in writing and should specifically state how and in what respects the assessment had been rectified. Where any amendment has the effect of enhancing the assessment or reducing the refund already made, the Assessing Officer shall serve on the assessee a notice of demand in the prescribed manner specifying the amount of tax, interest or other sum payable by him.

Time limit

The time limit for rectification of mistakes is a period of four years from the end of the financial year in which the order sought to be amended was passed.

where an application for an amendment under this section is made by the assessee on or after the 1st day of June, 2001 to an Income-tax authority referred to in Sub-section (1), the authority shall pass an order, within a period of six months from the end of the month in which the application is received by it:

– by making the amendment; or

REVIEW 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. What is self-assessment? What are the consequences of non-payment of tax on "Self-assessment"?
4. Discuss how regular assessments and best judgment assessments are made under the Act?
5. Under what circumstances is the Assessing Officer empowered to reopen the assessment made by him? Give example.
6. 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.
7. What is a mistake apparent from the record? Explain the specific cases of mistakes given in the Act
8. which are to be rectified and state the time limits for rectification in each case.
9. Write a lucid note on best judgment assessment with suitable illustration.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

UNIT-12 APPEALS, REVISIONS, SETTLEMENT OF CASES AND PENALTIES & OFFENCES

CONTENTS

- Introduction
- Appeal Before the Commissioner (Appeals)
- Revision by the Commissioner of Income Tax (Section 263 and 264)
- Revision of orders prejudicial to the interest of revenue (Section 263)
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- Appeal Before High Court
- Appeal Before Supreme Court
- Settlement of Cases [Sections 245A to 245L]
- Penalties and Offences
- Review Questions
- Further Readings

Appeal is a complaint to a superior court of an injustice done by an inferior one. The party complaining is termed as the "Appellant" and the other party is known as "Respondent".

INTRODUCTION

The right of appeal must be given by express enactment in the Act. Therefore, in case there is no provision in the Act for filing an appeal regarding a particular matter, no appeal shall lie. The right of appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. Where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order. Similarly, where an appellate authority accepts the contention of the taxpayer and allows the appeal, there is no further appeal by the assessee against that order.

The assessee may prefer an appeal against the orders of the Assessing Officer to the Commissioner (Appeals), in accordance with the relevant provisions under Section 246 and appeal against the order of the Commissioner (Appeals) can be preferred by the Assessee or the Commissioner of Income Tax and such appeal lies with the Appellate Tribunal.

The Finance (No.2) Act, 1998 has amended the provisions regarding remedy against order of Tribunal. Where earlier the assessee or the CIT, if not satisfied with the order of Tribunal, could only request the Tribunal to refer that matter to the High Court. After 1.10.98 as provided by Finance (No.2) Act, 1998 the assessee or CIT if not satisfied with the order of the tribunal can appeal directly to the High Court, if High Court is satisfied that the case involve a substantial question of law and if the assessee or Commissioner of Income-tax is not satisfied with the order passed by the High Court they may file an appeal against the order of the High Court to the Supreme Court. However, it should be noted that in the

case of question of fact tribunal is the final & binding authority and its decision is final.

APPEALABLE ORDERS BEFORE COMMISSIONER (APPEALS) (SECTION 246A)

Any assessee or any deductor aggrieved by any of the following orders may appeal to the Commissioner (Appeals):

(a) against an order passed by a Joint Commissioner under Clause (ii) of Sub-section (3) of Section 115VP or an order against the assessee where he denies his liability to be assessed under the Income Tax Act, or an intimation under section 143 (1) or (1B) or section 200A(1) where the assessee or deductor objects to making of adjustment or any order of assessment under section 143(3) except an order passed in pursuance of directions of Dispute Resolution Panel or Section 144 where assessee object to the amount of income assessed or amount of tax determined or amount of loss computed or status under which he is assessed;

(aa) an order of assessment under Sections 115WE or 115WF where the assessee being an employer objects to the value of fringe benefits assessed;

(b) against an order of assessment, re-assessment or re-computation under Section 147 except an order passed in pursuance of directions of dispute resolution panel or Section 150;

(ba) an order of assessment or reassessment under Section 153A except an order passed in pursuance of directions of dispute resolution panel;

(bb) an order of assessment or re-assessment under section 92CD(3);

(c) against an order of rectification of mistake under Section 154 or Section 155 having effect of enhancing assessment or reducing refund or order refusing to allow claim made by assessee under these sections;

(d) against an order under Section 163 treating the assessee as the agent of a non-resident;

(e) against an order under Section 170(2) or 170(3) relating to succession of business otherwise on death;

(f) against an order made under Section 171;

(g) against an order under Section 185;

(h) against an order cancelling the registration of firm under section 186(1) or (2);

(i) against an order under Section 237;

(j) against an order under Section 201 or 206 (C)(A);

(k) A person deemed to be an assessee in default for not collecting the whole or any part of tax or after collecting the tax, failing to pay the same, may appeal before Commissioner (Appeals) on or after April 1, 2007. (l) against an order imposing a penalty under Section 221, 271, 271A, 271AAA, 271AAB, 271F, 271FB, 272AA, Section 272, 272B, 272BB or Section 273;

(m) an order of imposing or enhancing penalty under Section 275(1A);

(n) against an order of assessment made by an assessing officer under clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account, other documents or any assets requisitioned under Section 132A;

(o) against an order imposing a penalty under Sub-section (2) of Section 158BFA;

(p) against an order imposing penalty under Section 271B or Section 271BB;

(q) against an order made by a Joint Commissioner imposing a penalty under Section 271C, Section 271CA, Section 271D or Section 271E;

(r) against an order made by a Joint Commissioner imposing a penalty under Section 272AA and by a Joint Commissioner or Joint Director under Section 279A;

(s) against an order imposing a penalty under Chapter XXI of Income tax Act;

(t) against an order made by an Assessing Officer other than a Joint Commissioner under the provisions of this Act, in case of specified person or classes of persons.

Where a person has deducted and paid tax in accordance with Section 195 and 200 in respect of any sum (other than interest) chargeable under the Act he is entitled to prefer an appeal under Section 248 to be declared not liable to deduct tax. In other words, the right to appeal under Section 248 is conditional and can be exercised only if tax is deducted at source and paid to the Government.

Section 248 has been substituted with effect from June 1, 2007. The modified version provides that where under an agreement or other arrangement, the tax deductible on any income (not being interest) under Section 195 is to be borne by the payer (i.e., "net of tax" arrangement) and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income.

PROCEDURE FOR FILING OF APPEAL [SECTION 249(1)]

The appeal should be filed in the prescribed form and verified in the prescribed manner. In case of an appeal
made to the Commissioner (Appeals) on or after the 1st day of October, 1998, it shall be accompanied by a fees
irrespective of the date of initiation of the assessment proceedings. The rates of fees are as follows:

– `250 when the assessed income is one hundred thousand rupees or less (income/loss) compute.

– ` 500 when the assessed income is more than one hundred thousand rupees but not more than two hundred thousand rupees.

– `1000 when the assessed income is more than two hundred thousand rupees.

– `250 in any other case.

Form No. 35 is the prescribed form [under Rule 45(1)] of the appeal. The form of appeal, the grounds and the verification appended to the form should be signed [Rule 45(2)] as per provisions applicable to the signing of return under Section 140. Form No.35 requires that the memorandum of appeal, statement of facts and the grounds of the appeal must be in duplicate and should be accompanied by a copy of the order appealed against and the notice of demand in original, if any.

PERIOD OF LIMITATION TO PREFER AN APPEAL [SECTION 249(2)]

The appeal has to be presented within the period of limitation as given below:

1. Appeal by person denying liability to deduct tax in respect of payments payable to non-resident or a foreign company [Section 249(2)(a)] : Where the appeal relates to any tax deducted at source from payment made to a non-resident, (other than a company) or to a foreign company, any interest, other 'than interest on securities or any other sum chargeable under the provisions of the Income Tax Act (not being salaries), within 30 days from the date of payment of tax deducted at source to the credit of the Central Government.
2. Appeal against assessment to penalty [Section 249(2)(b)] : Where the appeal relates to any assessment or penalty order the appeals have to be presented within 30 days of the date of service of the notice of demand relating to that assessment or penalty order.
3. Other appeals [Section 249(2)(c)] : In any other case, the appeal has to be presented within 30 days of the date on which intimation of the order sought to be appealed against is served on the appellant. In computing the period of limitation for an appeal or an application, the day on which the order is served has to be excluded. If the assessee was not furnished with a copy of the order along with the notice of the order, or demand, the time required for obtaining a copy of such order is also to be excluded and the date will be extended by that period. It may be noted that even where the assessee has not been supplied with copy of the order concerned, the time taken in making an application which does not comply with all the legal requirements cannot be excluded under the provisions of Section 268. If the application for obtaining the copy of the order has not been properly stamped or has been made by a person not authorised to do so, the time which has elapsed between the making of the invalid application and putting the application in order would not be excluded in computing the period of limitation.

If any appeal is filed after the period of limitation, the Commissioner (Appeals) may admit the appeal after the said period if he is satisfied that the appellant had sufficient cause for not presenting the appeal within that period [Section 249(3)]. Such delayed appeals must be accompanied by a condonation petition showing and explaining the reason/cause of the appellant for not being able to file the appeal within the period of limitation and praying for condemnation of the delay. The power to condone the delay is discretionary and the discretion must be judiciously exercised. The discretion is to be exercised where sufficient cause for not presenting the appeal within the time is made out by the appellant. The period for filing an appeal cannot be extended simply because the appellant's case is hard and calls for sympathy or merely out of benevolence to the party seeking relief. The sufficient cause must be a cause which is beyond the control of the party seeking the condonation of the delay. Illness is sufficient cause, if it can be shown that the man was utterly disabled to attend to any duty. The cause for delay in filing the appeal which, by due care and attention could have been avoided cannot be a sufficient cause. Negligence on the part of the servants or

agent entrusted with the filing of the appeal cannot be considered as a sufficient cause. The change of legal situation brought about by a decision of the Supreme Court may be valid ground for condoning delay. The words "sufficient cause" should receive a liberal interpretation so as to advance substantial justice where no negligence nor inaction nor want of bona fide is imputable to the applicant. An appeal presented after the period of limitation is still an "appeal" and an order dismissing it as time barred is one passed in appeal [under Section 250 and not under Section 249(3)]. An appeal lies therefrom to the Appellate Tribunal and thereafter to the High Court on a question of law.

PAYMENT OF TAX BEFORE FILING APPEAL [SECTION 249(4)]

No appeal against any order passed by the Assessing Officer can be admitted by the Commissioner (Appeals) unless at the time of filing of the appeal the assessee has paid tax due on the income returned by him, and where the assessee has not furnished the return of income, he has paid an amount equal to the amount of advance tax which was payable by him. If the appellant wants exemption from the payment of such tax he has to make an application to the Commissioner (Appeals) who is empowered to waive this requirement in appropriate cases if he is satisfied that there are good and sufficient reasons for doing so. In such cases, the Commissioner (Appeals) is required to record such reasons in writing. It may be noted that Income-tax law requires only the payment of tax before the filing of the appeal and not the payment of any penalty or any other sum payable by the assessee on the basis of the order appealed against.

PROCEDURE IN APPEAL (SECTION 250)

Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred.

The following shall have the right to be heard at the hearing of the appeal:

(a) The appellant, either in person or by an authorised representative.

(b) The Assessing Officer, either in person or by a representative.

The Commissioner (Appeals) shall have the power to adjourn the hearing of the appeals from time to time. He may, before disposing of any appeal, make such further enquiry as he deems fit, or may direct the Assessing Officer to make further enquiry and report as he deems fit, or may direct the Assessing Officer to make further enquiry and report the result of the same to the Commissioner (Appeals).

The Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the grounds of appeal if he is satisfied that the omission of that ground from the form of appeal was not willful or unreasonable. His order disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision. In every appeal, the Commissioner (Appeal), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed before him Commissioner (Appeal) under Section 246A(1). On the disposal of the appeal, the Commissioner

(Appeals) shall communicate the order passed by him to the assessee and to the Chief Commissioner or Commissioner.

POWERS OF THE COMMISSIONER (APPEALS) (SECTION 251)

In disposing of an appeal, the Commissioner (Appeals) shall have the following powers:

1. In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment.
2. In an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as to either enhance or reduce the penalty.
3. In any other case, he may pass such orders in the appeal as he deems fit.

The Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction. While disposing an appeal, the Commissioner (Appeals) may consider and decide the facts arising out of the proceedings which in respect of order appealed against were carried notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.

From the Assessment year 2009-10, in an appeal against the order of assessment in respect of which the proceedings before the Settlement Commission abates under the section 245HA, the Commissioner (appeals) can confirm, reduce, enhance or annul the assessment after taking into consideration of the following –

1. the material and other information produced by the assessee before the Settlement Commission
2. the results of the enquiry held by the Settlement Commission
3. the evidence recorded by the Settlement commission in the course of proceedings before it 4. such other material as may be brought on his record.

REVISION BY THE COMMISSIONER OF INCOME TAX (SECTIONS 263 AND 264)

The right to file such appeals against the orders of the Assessing Officer is not available to the Department. It is for this reason that the Commissioner has been vested with revisional powers under Section 263, where the order of the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue. But such revisional power can be exercised only in respect of orders which are not the subject matter of appeals. The reason is that once an assessment order is appealed against, the Commissioner (Appeals) has got the powers to enhance the assessment under Section 263 and a right of appeal upto the Tribunal is provided to the assessee against the orders of the Assessing Officer. In the following cases Commissioner of Income-tax can revise an order passed by the Assessing Officer:

REVISION OF ORDERS PREJUDICIAL TO THE INTEREST OF REVENUE (SECTION 263)

The Department has no right of appeal to the Commissioner (Appeals) against any order passed by the Assessing Officer. Therefore, the Commissioner of Income-tax has been empowered to revise such orders

of the Assessing Officer as are prejudicial to the interest of the revenue. Such power, however, is subject to certain conditions as given below :

1. Revision can be only of the order of Assessing Officer [Section 263(1)]

The Commissioner of Income-tax can revise only the orders of Assessing Officer. For the purposes of this clause,an order passed by the Assessing Officer includes an order of assessment passed on or before or after 1.6.1988, including: (i) an assessment order made by the Assistant Commissioner or the Income Tax Officer on the basis of the directions issued by the Joint Commissioner under Section 144A, (ii) an order made by the Joint Commissioner in exercise of the powers or in performance of the functions of an Assessing Officer conferred on, or assigned to him under the orders or directions issued by the Board or by the Chief Commissioner or Director General or Commissioner authorised by the Board in this behalf under Section 120 [Jurisdiction of Income Tax authorities]. In case the order referred to above has been the subject matter of any appeal filed on or before or after June1, 1988 the powers of the Commissioner shall extend and shall always be deemed to have extended to such matters as had not been considered and decided in such appeal. The appellate orders passed by the Commissioner (Appeals) are outside the purview of the revisional powers vested in the Commissioner of Income tax.

But if the assessment order of the Assessing Officer is pending in an appeal before the appellate authority (as aforesaid), it can be revised by the Commissioner of Income-tax. So long the appeal is not disposed of, the order of the Assessing Officer will be considered as subsisting and operative. Therefore, it can be revised.

2. Order erroneous and prejudicial to the interest of revenue [Section 263(1)]

If the Commissioner of Income-tax considers that the order of the Assessing Officer is erroneous in so far as it is prejudicial to the interest of the revenue, such order can be revised after giving the assessee an opportunity of being heard.

The word “erroneous” includes cases where there has been a failure to make the necessary enquiries. The Commissioner of Income-tax may consider an order of the Assessing Officer to be erroneous not only if it contains some apparent error of reasoning or of law or of fact on the face of it but also because it is a stereotype order which simply accepts what the assessee has stated in his return and fails to make enquiries which are called for in the circumstances of the case. The Assessing Officer is not only an adjudicator but also an investigator. He cannot remain passive in the face of a return which is apparently in order but calls for further enquiry. It is his duty to ascertain the truth of the facts stated in return when the circumstances of the case are such as to provoke enquiry.

The words “prejudicial to the interests of revenue” appearing under Section 263(1) have not been defined in the Act, but they must mean that the order of the Assessing Officer is such, that it is not in accordance with law in consequence whereof the lawful revenue due to the State has not been realised or cannot be realised. The Allahabad High Courts’ decision in Commissioner of Income-tax v. Sunder Lal (1974, 96 ITR

310) was followed by it in Commissioner of Income-tax v. Kashi Nath & Co. 1988, 170 ITR 28) holding that the power of the Commissioner of income-tax under Section 263 of the Income Tax Act is quasi-judicial in character. He must give reasons in support of his conclusion that the assessment order is erroneous in so far as it is prejudicial to the interests of the Revenue. If he does not give the reasons, the order can be vitiated. For example, if the Commissioner is of the opinion that the Assessing Officer had allowed deductions in excess of what they were due in a particular case, such order is erroneous and prejudicial to the interests of the revenue. Hence, it may be revised by the Commissioner of Income Tax.

In Malabar Industrial Co. Ltd. v. Commissioner Income Tax (1992,198 ITR 611) the Kerala High Court held that the words 'prejudicial to the interests of the revenue' are of wide import and they should not be limited to a case where the order passed by the Income-tax Officer (now Assessing Officer) can be considered to be one prejudicial to the revenue administration as such. The question whether an order of the Income Tax Officer is prejudicial to the interests of revenue would depend on the facts of each case and there can be no universal formula applicable to finding out any such prejudicial error. The High Court followed the rule laid down by the Supreme Court in Tara Devi Aggarwal v. CIT (1973, 88 ITR 523) but dissented from the rule laid down by the Madras High Court in Venkatakrishna Rice Co. v. CIT (1987, 163 ITR 129).

The Commissioner can revise an order passed by the Assessing Officer only if it is erroneous and prejudicial to
the interests of the revenue; if the order sought to be revised is not prejudicial to the interest of the revenue the Commissioner has no jurisdiction to revise it. The failure of the Assessing Officer to deal with the claim of the assessee in the assessment order may be an error, but an erroneous order by itself is not enough to give jurisdiction to the Commissioner to revise it under Section 263. It must be further shown that the order was prejudicial to the interests of the revenue.

3. Assessee to be given an opportunity of being heard [Section 263(1)]

The process of revision is completed in three stages: (i) the Commissioner may call for and examine the records of any proceeding under the Act which is within his administrative powers. If after examining the material and relevant facts on record, the Commissioner considers prima facie that any order of the Assessing Officer is erroneous and prejudicial to the interest of the revenue, he must, in the (ii) place, give the assessee an opportunity of being heard. The opportunity of being heard to be given to the assessee contemplates that the Commissioner must disclose to the assessee the grounds on which he desires to make a revision under Section 263. This is essential. If the assessee does not know on what points he is to be heard, he may not visualise what he has to say at the hearing and the opportunity of being heard may prove to be illusory. Further, the notice to show cause must be served on the assessee reasonably ahead of the date fixed for hearing, because the time allowed to the assessee to prepare the case should not be short but reasonable. The Commissioner is also required to examine

the merits of the objection raised by the assessee. Without going into the merits of the claim of the assessee, it is not possible for the Commissioner to say that the order of the Assessing Officer has caused any prejudice to the interests of the revenue. He may also cause enquiry to be made by his subordinates. Before making his order, he must disclose to the assessee the material collected by him on enquiry if he wants to use the materials collected from such inquiry against the assessee. If the matter collected from the enquiry is only supporting material and does not constitute the basic grounds on which the revision order is to be passed, the failure of the Commissioner to disclose to the assessee the fact of the enquiry does not vitiate the revision order. In the third stage, the Commissioner is required to pass the necessary order if he finally concludes that the order of the Assessing Officer is erroneous and prejudicial to the interests of the revenue. He can enhance or modify the assessment. He has also the power to cancel the assessment and direct a fresh assessment. The power of cancellation of the assessment with a direction to make a fresh assessment is called for only in cases where there is something totally or basically is wrong with the assessment which is not capable of being remedied by amendments to the assessment order itself. Where the Commissioner comes to the conclusion that there is a defect in the assessment order in so far as the question of the levy of interest was not considered by the Assessing Officer, the Commissioner should direct the Assessing Officer to consider the question on merits and in accordance with law after giving the assessee an opportunity of being heard. It is not further necessary for him, nor would the circumstances of the case justify, that the whole assessment should be set aside. Setting aside the assessment has got far reaching consequences and such power should be exercised only where the circumstances call for a remedial action. The revisional order must be a speaking order giving reasons for such revisions otherwise the order may be vitiated. The power of suo-moto revision of the Commissioner of Income tax under Section 263(1) is in the nature of supervisory jurisdiction and can be exercised only if the circumstances specified therein exist. Two circumstances must exist: (i) the order should be erroneous, and (ii) by virtue of the order being erroneous, prejudice must have been caused to the interests of the revenue. An order cannot be termed as erroneous unless it is not in accordance with law. If an Income-tax Officer acting in accordance with law makes certain assessment, the same cannot be termed as erroneous by the Commissioner simply because according to him, the order should have been written more elaborately. In this case, the Tribunal was held justified in setting aside the order passed by the Commissioner under Section 263.

4. Time limit for making the revisional order [Sections 263(2) and (3)]

The revisional order can be passed within two years from the end of the financial year in which the order sought to be revised was passed [Section 263(2)]. Once the revisional order is made within the time limit of two years from the end of the relevant financial year it is a valid order even if it is served on the assessee after the expiry of two years.

In computing the time limit of two years, the time taken in giving an opportunity to the assessee to be reheard (under Section 129) and any period during which the proceeding (under Section 263) is stayed by an order or injunction of any court is excluded [Explanation to Section 263(2)]. Order under Section 263 can't be passed to reduce tax utility or in favour of assessee. However Appeal against Section 263 can be made to ITAT. It may be noted that the limit of two years does not apply to a revisional order which had been passed in consequences of or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court. Such revisional order may be passed at any time [Section 263(3)].

REVISION OF ORDER IN THE INTEREST OF ASSESSEE (SECTION 264)

An aggrieved assessee has his normal right of appeal against the order of the Assessing Officer to Commissioner
(Appeals) under Section 246A and thereafter to the Appellate Tribunal under Section 253. Further, each and every order of the Assessing Officer is not appealable to the appellate authorities under Sections 246A and 253. The assessee may seek justice in such cases by making an application under section 264 to the Commissioner of Income Tax. For example, revision lies to the Commissioner against the levy of penal interest for not furnishing the return of total income within the prescribed time against which no appeal has been provided. The revisional order passed under Section 264 cannot be prejudicial to the interest of the assessee. The whole subject matter is discussed below –

1. Revision of order of subordinate authority only [Section 264(1) and Explanation 2]

The Commissioner of Income Tax may revise any order of an authority subordinate to him. Deputy Commissioner, Income Tax Officers and Inspectors of Income Tax are subordinate to the Commissioner according to Section 118.

2. Suo motu revision [Section 264(1) and (2)]

The Commissioner may, suo motu call for the record of any proceeding under this Act in which any, order has been passed by any authority subordinate to him. He may make such enquiry and may pass such order as he thinks fit but such order cannot be prejudicial to the assessee [Section 264(1)]. He may act in such circumstances without notice to the assessee and without giving him an opportunity of being heard. Such exercise of the authority is a purely departmental affair and the assessee may know nothing about this. While acting suo motu, the Commissioner may revise the order of his subordinate authority within one year from the date of the order sought to be revised [Section 264(2)]. If the order has been made more than one year back, such order cannot be revised by him.

It is obligatory on the Commissioner w.e.f. October 1, 1998 to pass an order under Section 264 within a period of one year from the end of financial year in which the application is made for revision. In computing the period of limitation, the time taken in giving an opportunity to the assessee to be re-heard (under Section 129) and any period during which any proceeding under this Section is stayed by an

order or injunction of any court is excluded. Though an order has, to be passed within one year, an order in revision may be passed at any time in consequence of or to give effect to any findings or directions contained in an order of the Appellate Tribunal, High Court or the Supreme Court.

3. Revision on application of the assessee [Section 264(1), (3) & (5)]

The assessee is entitled to make an application to the Commissioner of Income-tax for the revision of any order passed by an authority subordinate to him. Such an application can be made within one year from the date on which the order in question was communicated to him or from the date on which he otherwise came to know of it, whichever is earlier [Section 264(3)]. The Commissioner is empowered to admit a belated application if he is satisfied that the assessee was prevented by sufficient cause from making the application within the prescribed time.

The application for revision by the assessee is always to be accompanied by a fee of `500 [Section 264(5)]. On receipt of the revision application, the Commissioner may call for the record. He may make such enquiry and pass such order as he deems fit. Such an order should not be prejudicial to the assessee [Section 264(1)]. There are two important points of distinction between the cases: (i) where the Commissioner makes suo motu revision; and (ii) where he makes a revision on the application of the assessee. While acting suo motu, he can pass the revisional order only within one year from the date of the order sought to be revised. There is no such time limit when the revisional order is passed on the basis of application filed by the assessee. Once the application is made within the period of limitation prescribed therefor, or after the condonation of delay, the order may be passed at any time thereafter. Secondly, while acting suo motu, the Commissioner acts in the exercise of his administrative jurisdiction and, hence, he is not bound to give a hearing to the assessee. In fact the review is purely a departmental affair in such cases. On the other hand, when he is moved by the assessee for the said purposes, the jurisdiction conferred on him is a judicial one and, hence, he must give an opportunity to the assessee to put forward his case.

4. Nature of the order under Section 264

The Commissioner may pass such order as he thinks fit provided such order is not prejudicial to the assessee. This is so whether the Commissioner acts suo motu, or on the revision application of the assessee. An order of the Commissioner passed in revision can be said to be prejudicial to the assessee only when he is, as a result of it, placed in a different and worse position than that in which he was placed by the order under review'. If the Commissioner effects a reduction of income under one head and an increase under another but, on the whole reduces the assessment, his order cannot be said to be prejudicial to the assessee. Though the Commissioner may not change the order of the subordinate authority to the prejudice of the assessee, he may not give the relief asked for by the assessee. An order of the Commissioner declining to interfere with the order of the subordinate authority cannot be deemed to be an order prejudicial to the assessee (Explanation 1 to Section 264). The power to pass such orders as he deems fit is not an arbitrary one to be exercised according to his fancy. He must act according to the rules of

reason and justice, not according to private opinion, according to law not humor. His discretion is not to be arbitrary, vague and fanciful, but legal and regular. It is a power coupled with duty to exercise it in the interest of justice to the assessee.

CIRCUMSTANCES IN WHICH NO REVISION CAN BE MADE [SECTION 264(4)]

The Commissioner of Income-tax cannot revise the order of his subordinate authority in the following cases:

(i) If the order is appealable to the Commissioner (Appeals), such order cannot be revised until the time within which such appeal may be made expires. If an appeal has been made to the Commissioner (Appeals), the revisional power cannot be exercised while the appeal is pending but it may be exercised after the appeal has been disposed of. The Commissioner (Appeals) for the purpose of Section 264 is an authority subordinate to the Commissioner of Income-tax. Hence, the order of the Commissioner (Appeals) can be revised.

(ii) If the order is appealable to the Commissioner (Appeals) or the Appellate Tribunal, revisional power cannot be exercised until the time within which such appeal may be made expires. But, in such cases, if the assessee waives his right of appeal, the Commissioner may revise the order even before the time for appeal has expired. But once the order has been made the subject of an appeal the revisional powers come to an end. An order can be said to be made the "subject of an appeal" only when it is the subject of an effective appeal. If the Commissioner (Appeals) or the Appellate Tribunal refuses to entertain an appeal on the ground that it is time barred, or grants permission to the appellant to withdraw the appeal, the order cannot be said to be the "subject of an appeal" and the assessee would be entitled to apply to the Commissioner for revision.

REMEDY AGAINST THE REVISIONAL ORDER

An order of the Commissioner passed under Section 264 is not appealable to the Tribunal. Nor does a reference lie against such an order to the High Court since a reference to the High Court lies only against an order passed by the Tribunal. Since the order of the Commissioner is judicial or quasi-judicial in character, it is within the ambit of the High Court's jurisdiction under Article 226 of the Constitution and a petition for a writ of certiorari to quash an unjust or illegal order of the Commissioner is maintainable.

APPELLATE TRIBUNAL (SECTION 252)

The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act. The ITAT is constituted and works under the Ministry of Law. It is thus a body outside the administrative control of the Central Board of Direct Taxes. The Appellate Tribunal is not an Income-tax Authority in the sense of being an integral part of the department. On the contrary, by its constitution, powers and jurisdiction, not to speak of the manner of their recruitment, the Tribunal is an independent arbitral tribunal. The proceedings before it are advisory. It has also the trappings of a judicial body in the sense that it has to deal with the Department on the one side, and the assessee on the other in as

much as they face each other as opposing parties. In such a situation the Tribunal has to decide only those issues which are properly raised before it by the one or the other party in the appeal or in the cross objections. Under the Act, the Tribunal has got to decide an appeal and not merely give it a disposal by dismissing it for default of appearance. This, however, does not mean that the Tribunal has got to take upon themselves the responsibility of finding facts or points of law which are not urged by the Department or the assessee, as the case may be. CIT v. A. C. Paul (1983) 142 ITA 811 (Mad.).

The Tribunal is the final Authority and ordinarily, if after considering the matters in the proper perspective and after surveying all material which is available to it, the Tribunal arrives at some conclusion one way or the other, that conclusion would have to be respected, unless it can be regarded as impossible or perverse. CIT v. Lalchand Bhabutmal Jain (1985) 151 ITR 360 (Bom.).

APPEALABLE ORDERS [SECTION 253(1) AND (2)]

Any assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order. 1. An order passed by Commissioner (Appeals) under Section 154 ordering a rectification of mistake, or under Section 250 in connection with the disposal of an appeal or Section 271 imposing a penalty for failure to furnish return etc. or Sections 271 A or 272A.

2. An order passed by an assessing officer under Clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account other documents or any assets requisitioned under Section 132A, after the 30th day of June, 1995 but before the 1st day of January, 1997.

3. An order passed by a Commissioner under Section 12AA relating to registration of trust or under Section 263 relating to revision of orders prejudicial to revenue or under Section 272A penalty for failure to answer question, sign statements, allow inspection etc., on or under Section 154 rectifying a mistake, or an order passed by a Chief Commissioner, or a Director General or a director under Section 272A.

4. An order passed by an Assessing Officer under Sub-section (1) of Section 115VZC.

5. An order passed by a Commissioner for rejection of approval under Section 80G(5)(vi).

6. An order passed by an Assessing Officer under section 143(3) or section 147 or section 153A or section 153C with the approval of the commissioner or an order passed under section 154 or section 155.

The Commissioner may, if he objects to any order passed by Commissioner (Appeals) under Section 154 or 250, direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

PROCEDURE FOR FILING APPEAL [SECTION 253(3), (4)&(6)]

Every appeal to the Appellate Tribunal shall be filed within sixty days of the date on which the, order sought to be appealed against is communicated to the assessee or to the Commissioner, as the case may be. The Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of the Commissioner (Appeals) has been preferred by the other party may, notwithstanding that he may not have appealed against such order or any part thereof, within thirty

days of the receipt of notice, file a memorandum of cross-objections, verified in the prescribed manner, against any part of the order of the Commissioner (Appeals) and such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the specified period.

The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the relevant period if it is satisfied that there was sufficient cause for not presenting it within that period. An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall, in case of an appeal made on or after the 1st day of October, 1998, irrespective of the date of initiation of the assessment proceedings be accompanied by a fine of :

(a) ` 500 where the assessed income/loss is 1,00,000 rupees or less.

(b) ` 1,500 where the assessed income/loss is more than one hundred thousand rupees but not more than two hundred thousand rupees.

(c) One percent of the assessed income, subject to a maximum of ten thousand rupees where the assessed income is more than two hundred thousand rupees,

(d) ` 500 in any other case, except in case of an appeal filed by the department or a memorandum of crossobjections. An application for stay of demand has to be accompanied by a fee of ` 500.

In making an appeal to the Tribunal, the following documents shall be sent in triplicate.

(a) The memorandum of appeal.

(b) The grounds of appeal.

(c) Copy of the order of the Commissioner (Appeals).

(d) Copy of the grounds of appeal and statement of facts filed before the Commissioner (Appeals).

(e) Copy of the order of the Assessing Officer.

(f) Challan for payment of requisite fee.

Where the appellant desires to refer to any documents or evidence he is permitted to file the same with Tribunal in the form of a paper book within one month from the date of filing the appeal. Though the prescribed period in one month, it will be preferable to file the same along with the appeal. Where an appellate order by the Commissioner (Appeals) is passed as a consolidated order for a number of years, appeals to the Tribunal shall be filed separately for each year.

ORDER OF APPELLATE TRIBUNAL (SECTION 254)

The Appellate Tribunal may, after giving both the parties to appeal an opportunity of being heard, pass such orders thereon as it may think fit.

The Appellate Tribunal may, at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it and shall make such amendment if the mistake is brought to its notice by the assessee or the Assessing Officer. But, any amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made unless the Appellate Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard.

The Tribunal's decision would have binding effect within the jurisdiction and has a persuasive value outside its
jurisdiction. Sub-sections (2A) and (2B) have been inserted by Finance Act, 1999 w.e.f. 1.6.99. Sub-section (2A) provides that in every appeal, the Appellate Tribunal, where it is possible may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed under Section 253(1). Subsection (2B) provides that the cost of any appeal to the Appellate Tribunal shall be at the discretion of the Tribunal.

Section 254(2A) pertaining to stay of demand by the Appellate Tribunal has been modified as follows:

1. Initially the Tribunal can pass an order of the stay only for a period not exceeding 180 days from the date of the order staying the demand.
2. The tribunal shall dispose of appeal within the aforesaid period.
3. If appeal is not disposed of within the aforesaid period, the period of stay may be extended. The total period of stay cannot be more than 365 days reckoned from the beginning of the period. Extension is possible only if delay is not attributable to assessee.
4. Appeal shall be disposed of by the Tribunal within the extended period.
5. If appeal is not disposed of within the extended period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

The Appellate Tribunal shall send a copy of any orders passed under this section to the assessee and to the Commissioner. On question of fact, the order passed by the Appellate Tribunal on appeal shall be final. An order made by the Appellate Tribunal shall be sufficiently comprehensive and self-contained. It should be possible to ascertain from the order all the relevant facts and the questions arising on the appeal. It should also disclose what were the contentions of the parties and should state why and for what reasons those contentions were repelled.

Under Section 254(1), the Tribunal may, after giving both parties to the appeal an opportunity of being heard, pass such-orders thereon as it deems fit.

No limitation has been placed on the powers of the Commissioner (Appeals) or the Appellate Tribunal under Section 251(1) or 254(1). The only limitation on their appellate jurisdiction is that they cannot go into the question of propriety of an ex-parte proceeding or a best judgement assessment. The quantum of assessment, the
quantum of tax or the question of registration of a firm can always be gone into. Vishnu Kumar Gupta v. CIT (1983) 143 ITR 169 (All). However, the power of stay is not likely to be exercised in a routine way or as a matter of course in view of the special nature of taxation and revenue laws. Only when a strong prima facie case is made out, the Tribunal will consider whether to stay the recovery proceedings. Stay will be granted only in deserving and appropriate cases and where the Tribunal is satisfied that the entire purpose of the appeal will be frustrated or rendered nugatory by allowing the recovery proceedings to continue during the dependency of the appeal before it.

Section 254(1) empowers the Appellate Tribunal to give its decision on the grounds urged and it can pass appropriate orders. It is not open to the Tribunal itself to raise a ground or permit the party who had not appealed to raise a ground which will work adversely on the appellants.

Under Section 254(2), the Appellate Tribunal has got ample power to rectify a mistake apparent from record suo
motu. If the mistake is brought to the notice of the Tribunal by the parties to the appeal, the Tribunal is empowered to rectify the same. Addl. CIT v. ITAT (1983) 139 ITR 615 (AP).

From the Assessment year 2009-10(w.e.f.1.10.2008),the third proviso to sub-section (2A) provides that if such appeal is not decided within the period allowed originally or the periods so extended or allowed ,the order of stay shall stand vacated after expiry of such period or periods.

The intention behind these provisions has been very clear that the Appellate tribunal cannot grant stay either under the original order or any other subsequent order, beyond the period of 365 days in aggregate. If the Tribunal is unable to decide the appeal on the basis of materials before it, it may admit fresh evidence and decide the appeal. It may also keep the appeal pending and direct any one of the subordinate authorities to ascertain further facts.

PROCEDURE OF APPELLATE TRIBUNAL (SECTION 255)

The powers and functions of the Appellate Tribunal may be exercised and discharged by benches constituted by the President of the Appellate Tribunal from amongst the members thereof. The bench shall consist of one judicial member and one accountant member. The President or any other member of the Appellate Tribunal, authorised in this behalf by the Central Government, may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose, total income as computed by the Assessing Officer in the case does not exceed `5,00,000. The President may, for the disposal of any particular case, constitute a Special Bench consisting of three or more members, one of whom shall necessarily be a judicial member and one an accountant member. If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority if there is a majority. But if the members are equally divided, they shall state the point or points on which they differ and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal. Such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case including those who first heard it.

The Appellate Tribunal shall have the power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Benches shall hold their sittings.

The Appellate Tribunal shall have, for the purpose of discharging its functions, all the powers which are vested in the Income-tax authorities under Section 131, and any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding and for the purpose of Section 196 of the Indian Penal Code, the Appellate Tribunal shall be

deemed to be a Civil Court for all purposes of Section 195 and Chapter XXXV of the Code of Criminal Procedure.

The Appellate Tribunal is a final fact finding authority and if it arrives at its own conclusions or facts after the consideration of the evidence before it, the Court will not interfere. It is necessary, however, that every fact 'for' and 'against' the assessee must have been considered with due care and the Tribunal must have given its finding in a manner which would have clearly indicated what were the questions which arose for determination, what was the evidence pro and contra in regard to each one of them, and what were the findings reached on the evidence on record before it.

Notes

APPEAL TO HIGH COURT

Sections 260A and 260B are inserted w.e.f. October 1, 1998. Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law.

The Chief Commissioner or the Commissioner or an assessee aggrieved by any order passed by the Appellate
Tribunal may file an appeal to the High Court and such appeal shall be filed within 120 days of the date on which the order appealed against is received by the assessee or the Chief Commissioner or Commissioner and shall be filed in the form of memorandum of appeal precisely stating the substantial question of law involved. If the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question. The appeal shall be heard only on the question so formulated, and the respondents shall at the hearing of the appeal, be allowed to argue that the case does not involve such question. However, the High Court may for reasons to be recorded, hear the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the
grounds on which such decision is founded and may award such cost as it deems fit. The High Court may determine any issue which has not been determined by the Appellate Tribunal or has been wrongly determined by the Appellate Tribunal on such substantial question of law. Where the High Court delivers a judgement in an appeal filed before it under Section 260A, effect shall be given to the order passed on the appeal by the Assessing Officer on the basis of a certified copy of judgement [Section 260(1A)].

Section 260B provides that an appeal filed under Section 260A shall be heard by a bench of not less than two judges of the High Court and shall be decided in accordance with the opinion such Judges or the majority, if any. Where, however, there is no such majority, the part of law upon which they differ shall be referred to one or more of the Judges of the High Court and shall be decided according to the opinion of the majority of the Judges who have heard the case including those who first heard it.

The High Court also has power to stay a proceeding for recovery of demand arising out of the assessment order pending disposal of appeal.

APPEAL TO THE SUPREME COURT (SECTION 261)

The aggrieved party is entitled to appeal to the Supreme Court against the judgment delivered by the High Court on the reference application made to it by the Tribunal (under Section 256) against an order made under Section 254 before the 1st day of October, 1998 or an appeal made to High Court in respect of an order passed under Section 254 on or after that date provided the High Court certifies the case to be fit for appeal to the Supreme Court. The right of appeal is, therefore, conditional and may be availed of only if the High Court gives a certificate of such fitness.

The High Court could certify the case as a fit one for appeal and grant leave to the Supreme Court if a substantial question of law is involved or if the question is likely to come up in successive year or if the question is otherwise of great public or private importance.

An application of fitness for appeal to the Supreme Court has to be made within 60 days from the date of High Court's judgment (under Article 132 of the Schedule to the Limitation Act, 1963). The time required for taking a certified copy of the High Court's judgment is to be excluded in computing such period of limitation.

If the High Court refuses to certify a case to be fit for appeal to the Supreme Court, an application may be made to the Supreme Court (under Article 136 of the Constitution) for special leave to appeal against the decision of the High Court.

The provisions of the Code of Civil Procedure, 1908 relating to the appeal to the Supreme Court are applicable in the case of appeals under Section 261 in the same manner as they are applicable in the case of appeals from decrees of a High Court [Section 262(1)].

Where the judgment of the High Court is changed or reversed in the appeal, effect is given to the order of the Supreme Court [Section 262(3)]. The law declared by the Supreme Court is binding on all courts within the territory of India under Article 141 of the Constitution.

On the receipt of a copy of judgment, the Appellate Tribunal has to pass such orders as are necessary to dispose of the case conformably to such judgment.

To award the cost of an appeal is at the discretion the Supreme Court [Section 262(2)]. It would be open to the Court not to award costs even to the party which has succeeded in the appeal before it. If the Supreme Court awards costs to a party and the party has not complied with the order, a petition may be made to the appropriate High Court for execution of the order of the Supreme Court (Section 266). The High Court may transmit the order for execution to any court subordinate to it (Section 266). Section 257 enables the Appellate Tribunal to make a direct reference to the Supreme Court if the Tribunal is of the opinion that, on account of a conflict in the decision of High Court in respect of any particular question of law, it is expedient that a reference should be made directly to the highest court.

SETTLEMENT OF CASES [Sections 245A to 245L]

Chapter XIXA provides for settlement of the cases which may be pending before an Income-tax authority. Further an appeal to the Appellate Tribunal by the assessee, and which is pending before it, may be withdrawn by the assessee with the permission of the tribunal, to have

his case settled under Sections 245A to 245L. Accordingly the Central Government constituted an Income-tax Settlement Commission consisting of a chairman and as many Vice- Chairman and other members as considered appropriate by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and, experience in problems relating to direct taxes and business accounts. However, in the event of a member of the CBDT having been appointed as the Chairman, Vice-Chairman or member of the Commission, he shall cease to be a member of the Board.

MEANING OF THE TERMS 'CASE' [Section 245A(b)]

"case" means any proceeding for assessment under this Act, of any person in respect of any assessment year or assessment years, which may be pending before an Assessing Officer on the date on which an application under Section 245C(1) is made.

Proceeding of assessment for which an application can not be made to the Settlement commission : In the following cases though the proceeding is pending before the assessing officer, the assessee shall not be allowed to make the application to the Settlement Commision;

(a) A proceeding for assessment or reassement under section 147 and such proceeding shall be deemed to be commenced from the date on which a notice under section 148 is issued.

(b) A proceeding for assessment or reassessment for any of the six assessment years referred to in section 153A(b) in case of a person reffered in section 153A or section 153C. These proceeding shall be deemed to be commenced from the date of initiation of the search under section 132 or requisition under section 132A (omitted by Finance Act,2010 w.e.f 01/06/2010).

(c) A proceeding for assessment or reassessment for any of the six assessment years referred to in section 153B(1)(b) in case of a person reffered in section 153A or section 153C. Such proceeding shall be deemed to be commenced from the date of initiation of the search under section 132 or requisition under section 132A (omitted by Finance Act,2010 w.e.f 01/06/2010).

It is now proposed by Finance Act, 2010) to include proceedings for assessment or reassessment resulting from search or as a result of requisition of books of account or other documents or any assets, within the definition of a "case" which can be admitted by the Settlement Commission. The date on which the proceedings for assessment or reassessment shall be deemed to have commenced on the date of issue of notice initiating such proceedings and concluded on the date on which assessment is made.(inserted by Finance Act, 2010). . (d) A proceeding for making fresh assessment in pursuance of an order under section 254 or section 263 or section 264, setting aside or cancelling an assessment. Such proceeding shall be deemed to be commenced from the date on which the order under section 254,263 or 264, setting aside or cancelling an assessment was passed.

JURISDICTION AND POWERS OF SETTLEMENT COMMISSION [Section 245BA]

Subject to the other provisions of this Chapter, the jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches thereof.

Subject to the other provisions of this section, a Bench shall be presided over by the Chairman or a Vice- Chairman and shall consist of two other Members. The Bench for which the Chairman is the Presiding Officer shall be the principal Bench and the other Benches shall be known as additional Benches.

When one of the persons constituting a Bench (whether such person be the Presiding Officer or other Member of the Bench) is unable to discharge his functions owing to absence, illness or any other cause or in the event of the occurrence of any vacancy either in the office of the Presiding Officer or in the office of one or the other Members of the Bench, the remaining two persons may function as the Bench and if the Presiding Officer of the

Bench is not one of the remaining two persons, the senior among the remaining persons shall act as the Presiding Officer of the Bench :

The Chairman may, for the disposal of any particular case, constitute a Special Bench consisting of more than three Members.] The places at which the principal Bench and the additional Benches shall ordinarily sit shall be such as the Central Government may, by notification in the Official Gazette, specify and the Special Bench shall sit at a place to be fixed by the Chairman

APPLICATION FOR SETTLEMENT OF CASES [Section 245C]

An assessee may, at any stage of a case relating to him, make an application in the prescribed Form (Form No.34B) alongwith the prescribed fee to the Settlement Commission to settle the case. Such an application once made cannot be withdrawn by the applicant. The assessee's application has to be made:

– in such form and in such manner as may be prescribed and

– containing full and true disclosure of his income, which has not been disclosed before the Assessing Officer,

– the manner in which such income has been derived,

– the additional amount of income-tax payable on such income and

– such other particulars as may be prescribed.

Such application can be made to the settlement commission only;

1. where the additional amount of income- tax payable on the income disclosed in the application exceeds 3 lac rupees; and

2. such tax and interest thereon, which would have been paid under the provisions of this Act, had the income disclosed in the application been declared in the return of income before the assessing officer on the date of the application, has been paid on or before the date of making the application and proof of such payment is attached with the application.

The following paragraph shall be applicable from 01-06-2010 in place of the above mention (1) & (2):

1. In a case where proceedings for assessment or reassessment have been initiated as a result of search or as a result of requisition of books of account or other documents or any assets, if the additional amount of

income-tax payable on the income disclosed in the application exceeds fifty lakh rupees. (Inserted by Finance Act,2010 w.e f 01-06-2010)

2. In any other case, if the additional amount of income-tax payable on the income disclosed in the application exceeds ten lakh rupees. (Inserted by Finance Act,2010 w.e f 01-06-2010).

Such tax and interest thereon shall be paid before making an application and the proof of such payment is attached with the application.

The additional Income-tax mentioned above shall be the amount calculated in accordance with the following points:

I. When income disclosed in the application relates only to one previous year -

A. (i) if the applicant has not furnished a return in respect of the total income of that year (whether or not an assessment has been made in respect of the total income of that year), then, except where the proceeding pending before the income-tax authority is in the nature of a proceeding for assessment or reassessment, tax shall be calculated on the income disclosed in the application as if such income were the total income;

(ii) if the applicant has furnished a return in respect of the total income of that year (whether or not an assessment has been made in pursuance of such return), tax shall be calculated on the aggregate of the total income returned and the income disclosed in the application as if such aggregate were the total income;

(iii) if the proceeding pending before the Income-tax authority is in the nature of a proceeding for reassessment of the applicant under Section 147 or by way of appeal or revision in connection with such re-assessment, and the applicant has not furnished a return in respect of the total income of that year in the course of such proceeding for re-assessment, tax shall be calculated on the aggregate of the total income as assessed in the earlier proceeding for assessment under Section 143 or 144 or 147 and the income disclosed in the application as if such aggregate were the total income.

B. The additional amount of income-tax payable in respect of the income disclosed in the application relating to the previous year referred to in Sub-section (1B) shall be,

(a) in a case referred to at (i) hereinabove, the amount of tax calculated under that clause;

(b) in a case referred to at (ii) hereinabove, the amount of tax calculated on the total income returned for that year;

(c) In a case referred to at (iii) hereinabove, the amount of tax calculated thereunder in the earlier proceeding for assessment under Sections 143, 144 or 147;

II. Where income disclosed in the application relates to more than one previous year, the income-tax shall be calculated in the above manner for each of the years separately and then aggregated and that will be the actual amount payable.

III. Where any books of accounts and unexplained valuables are seized under Section 132, the Assessee
can make the application for settlement only after 120 days of the seizure.

PROCEDURE ON RECEIPT OF AN APPLICATION UNDER SECTION 245C [Section 245D]

(1) On receipt of an application under section 245C, the Settlement Commission shall, within seven days from the date of receipt of the application, issue a notice to the applicant requiring him to explain as to why the application made by him be allowed to be proceeded with, and on hearing the applicant, the Settlement Commission shall, within a period of fourteen days from the date of the application, by an order in writing, reject the application or allow the application.

Provided that where no order has been passed within the aforesaid period by the Settlement Commission, the application shall be deemed to have been allowed.

(2) A copy of every order under sub-section (1) shall be sent to the applicant and to the Commissioner.

(2A) Where an application was made under section 245C before the 1st day of June, 2007, but an order under the provisions of sub-section (1) of this section, as they stood immediately before their amendment by the Finance Act, 2007, has not been made before the 1st day of June, 2007, such application shall be deemed to have been allowed to be proceeded with if the additional tax on the income disclosed in such application and the

interest thereon is paid on or before the 31st day of July, 2007.

Explanation. In respect of the applications referred to in this sub-section, the 31st day of July, 2007 shall be deemed to be the date of the order of rejection or allowing the application to be proceeded with under subsection (1). (2B) The Settlement Commission shall,

(i) in respect of an application which is allowed to be proceeded with under sub-section (1), within thirty days from the date on which the application was made; or

(ii) in respect of an application referred to in sub-section (2A) which is deemed to have been allowed to be proceeded with under that sub-section, on or before the 7th day of August, 2007, call for a report from the Commissioner, and the Commissioner shall furnish the report within a period of thirty days of the receipt of communication from the Settlement Commission.

(2C) Where a report of the Commissioner called for under sub-section (2B) has been furnished within the period specified therein, the Settlement Commission may, on the basis of the report and within a period of fifteen days of the receipt of the report, by an order in writing, declare the application in question as invalid, and shall send the copy of such order to the applicant and the Commissioner:

Provided that an application shall not be declared invalid unless an opportunity has been given to the applicant of being heard:

POWER OF SETTLEMENT COMMISSION

Power of Settlement Commission to Order Provisional Attachment to Protect Revenue (Section 245DD)

(1) During the pendency of any proceeding before the settlement commission, it (the settlement commission) can attach provisionally any property belonging to the applicant in the manner provided in the second schedule

if it is of the opinion that it is necessary to do so for protecting the interests of the revenue.

Provided that where, a provisional attachment made under Section 281B is pending immediately before an application is made under Section 245C, an order under this sub-section shall continue such provisional attachment upto the period upto which an order made under Section 281B would have continued if such application had not been made.

Further provided that where the Settlement Commission passes an order under this sub-section after the expiry of the period referred to in the preceding proviso, the provisions of Sub-section (2) shall apply to such order as if the said order had originally been passed by the Settlement Commission.

(2) Every provisional attachment made by the Settlement Commission under Sub-section (1) shall cease to have effect after the expiry of a period of six months from the date of the order made under Sub-section (1):

Provided that the Settlement Commission may, for reasons to be recorded in writing extend the aforesaid period

by such further period or periods as it thinks fit, so, however, that the total period of extension shall not in any case exceed two years.

Power of Settlement Commission to Re-Open Completed Proceedings (Section 245E)

If the Settlement Commission is of the opinion (the reasons for such opinion to be recorded by it in writing) that for the proper disposal of the case pending before it, it is necessary or expedient to re-open any proceeding connected with the case but which has been completed under this Act by any income-tax authority before the application under Section 245C was made, it may, with the concurrence of the applicant, re-open such proceeding and pass such order thereon as it thinks fit as if the case in relation to which the application for settlement had been made by the applicant under that section covered such proceeding also.

But no proceeding shall be re-opened by the Settlement Commission under this section if the period between the end of the assessment year to which such a proceeding relates and the date of application for settlement under Section 245C exceeds nine years.

And no proceeding shall be reopened by the Settlement Commission under this section in a case where an application is made on or after 1st day of June 2007.

Powers and Procedure of Settlement Commission (Section 245F)

(1) In addition to the powers conferred on the Settlement Commission under this Chapter, it shall have all the powers which are vested in an income-tax authority under this Act.

(2) Where an application made under Section 245C has been allowed to be proceeded with under Section 245D, the Settlement Commission shall, until an order is passed under Sub-section (4) of Section 245D, have subject to the provisions of Sub-section (3) of that section, exclusive jurisdiction to exercise the powers and perform the functions of an income-tax authority under this Act in relation to the case.

(3) Notwithstanding anything contained in Sub-section (2) and in the absence of any express direction to the contrary by the Settlement

Commission, nothing contained in this section shall affect the operation of any other provision of this Act requiring the applicant to pay tax on the basis of self-assessment in relation to the matters before the Settlement Commission.

(4) For the removal of doubts, it is declared that, in the absence of any express direction by the Settlement Commission to the contrary, nothing in chapter XIX-A shall affect the operation of the provisions of this Act in so far as they relate to any matters other than those before the Settlement Commission.

(5) The Settlement Commission shall, subject to the provisions of Chapter XIX-A have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of
the discharge of its functions, including the places at which the Benches shall hold their sittings.

Inspection, etc., of Reports (Section 245G)

No person shall be entitled to inspect, or obtain copies of, any reports made by any income-tax authority to the Settlement Commission; but the Settlement Commission may, in its discretion, furnish copies thereof to any such person on an application made to it in this behalf and on payment of the prescribed fee which is 80 paise for the first two hundred words or less and 40 paise for every additional hundred words or less.

Provided that, for the purpose of enabling any person whose case is under consideration to rebut any evidence
brought on record against him in any such report, the Settlement Commission shall, on an application made in
this behalf, and on payment of the prescribed fee by such person, furnish him with a certified copy of any such
report or part thereof relevant for the purpose.

Power of Settlement Commission to Grant Immunity from Prosecution and Penalty [Section 245H(1)]

The Settlement Commission may, if it is satisfied that any person who made the application for Settlement under Section 245C has co-operated with the Settlement Commission in the proceedings before it, and has made a full and true disclosure of his income and the manner in which such income has been derived, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act or under the Indian Penal Code (45 of 1860) or under any other Central Act for the time being in force and also (either wholly or in part) from the imposition of any penalty under this Act, with respect to the case covered by the Settlement. Provided that no such immunity shall be granted by the Settlement Commission in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of the application under Section 245C.

(1A): An immunity granted to a person under Sub-section (1) shall stand withdrawn if such person fails to pay any sum specified in the order of settlement passed under Sub-section (4) of Section 245D within the time specified in such order or within such further time as may be allowed by the Settlement Commission, or fails to comply with any other condition

subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.

(2) An immunity granted to a person under Sub-section (1) may, at any time, be withdrawn by the Settlement Commission, if it is satisfied that such person had, in the course of settlement proceedings, concealed any particulars material to the settlement or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appear to have been guilty in connection with the settlement and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Power of Settlement Commission to send a Case Back to the Assessing Officer if the Assessee does not Co-Operate (Section 245HA)

(1) The Settlement Commission may, if it is of the opinion that any person who made an application for settlement under Section 245C has not co-operated with the Settlement Commission in the proceedings before it, send the case back to the Assessing Officer who shall thereupon dispose of the case in accordance with the provisions of this Act as if no application under Section 245C had been made.

(2) For the purposes of Sub-section (1), the Assessing Officer shall be entitled to use all the materials and other information produced by the Assessee before the Settlement Commission or the results of the inquiry held or evidence recorded by the Settlement Commission in the course of the proceedings before it as if such materials, information, inquiry and evidence had been produced before the Assessing Officer or held or recorded by him in the course of the proceedings before him.

(3) For the purposes of the time-limit under Sections 149, 153, 154, 155 and 231 and for the purpose of payment of interest under Sections 243 and 244, in a case referred to in Sub-section (1), the period commencing on and from the date of the application to the Settlement Commission under Section 245C and ending with the date of receipt by the Assessing Officer of the order of the Settlement Commission sending the case back to the Assessing Officer shall be excluded; and where the assessee is a firm, for the purposes of the time limit for cancellation of registration of the firm under Sub-section (1) of Section 186, the period aforesaid shall, likewise, be excluded.

Order of Settlement to be Conclusive (Section 245-I)

Every order of settlement passed under Sub-section (4) of Section 245D shall be conclusive as to the matters stated therein and no matter covered by such order shall, save as otherwise provided in this chapter, be reopened

in any proceeding under this Act or under any other law for the time being in force.

Recovery of Sums Due Under Order of Settlement (Section 245-J)

Any sum specified in an order of settlement under Sub-section (4) of Section 245D may, subject to such conditions, if any, as may be specified therein, be recovered, and any penalty for default in making payment of such sum may be imposed and recovered in accordance with the provisions of Chapter XVII, by the Assessing Officer having

jurisdiction over the person who made the application for Settlement under Section 245C.

Bar on Subsequent Application for Settlement in Certain Cases (Section 245-K)

Where,

(i) an order of settlement passed under Sub-section (4) of Section 245D provides for the imposition of a penalty on the person who made the application under Section 245C for settlement, on the ground of concealment of particulars of his income; or

(ii) after the passing of an order of settlement under the said Sub-section (4) in relation to a case, such person is convicted of any offence under Chapter XXII in relation to that case; or (iii) the case of such person is sent back to the Assessing Officer by the Settlement Commission under Section 245HA,

then, he shall not be entitled to apply for settlement under Section 245C in relation to any other matter. **Proceedings before Settlement Commission to be Judicial Proceedings (Section 245-L)**

Any proceeding under this Chapter before the Settlement Commission shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purposes of Section 196 of the Indian Penal Code (45 of 1860).

DEFAULTS AND PENALTIES

An assessee should note that compliance with legal formalities is less costly than the payment of penalties or interest on tax dues. There are several formalities to be complied with to avoid any penalty. In this connection, reference may be made to the following table summarizing the defaults and penalties therefor.

REVIEW QUESTIONS

1. Explain the provisions with respect to appeals and revisions with reference to tax planning.
2. Explain the provisions relating to revision of assessment order prejudicial to the interest of assessee.
3. What are the various grounds of appeals available before different types of authorities to the assessee?
4. Under what circumstances the assessment order can be revised on the basis of applications of the assessee? Under what circumstances the revision cannot be made ?
5. Under what circumstances can an assessee appeal to the Appellate Tribunal? What documents are to be attached in mailing an appeal to the Tribunal?
6. When can an aggrieved party appeal to the Supreme Court against the judgment delivered by the High Court?

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.

UNIT-13 TAX PLANNING & TAX MANAGEMENT

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CONCEPT OF TAX PLANNING

Tax Planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc., to reduce income and/or capital gains. Tax planning can be defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum. In other words, all arrangements by which the tax is saved by ways and means which comply with the legal obligations and requirements and are not colourable devices or tactics to meet the letters of law but not the spirit behind these, would constitute tax planning.

The Hon'ble Supreme Court in McDowell & Co. v. CTO (1985) 154 ITR 148 has observed that "tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods." Tax planning should not be done with intent to defraud the revenue; though all transactions entered into by an assessee could be legally correct, yet on the whole these transactions may be devised to defraud the revenue. All such devices where statute is followed in strict words but actually spirit behind the statute is marred would be termed as colourable devices and they do not form part of tax planning. All transactions in respect of tax planning must to be in accordance with the true spirit of statute and should be correct in form and substance.

Various judicial pronouncements have laid down the principle that substance and form of the transactions shall be seen in totality to determine the net effect of a particular transaction. The Hon'ble Supreme Court in the case of CIT v. B M Kharwar (1969) 72 ITR 603 has held that, " The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of relationship. But the legal effect of a transaction can not be displaced by a probing into substance of the transaction." The form and substance of a transaction is real test of any tax-planning device. The form of transaction refers to transaction, as it appears superficially and the real intention behind such transaction may remain concealed. Substance of a transaction refers to lifting the veil of legal documents and ascertaining the true intention of parties behind the transaction.

How Tax is levied

Before a discussion is made concerning the concept of tax planning in detail it needs to be understood as to how
tax is levied. Liability of tax depends upon the charging section in the statute vis-a-vis 'taxable person', 'taxable event' and 'subject matter of taxation'. For understanding these inter-related but distinct concepts reference may be made to the Supreme Court's decision in State of Tamil Nadu v. M.K. Kandaswami (1975, 36 STC 191). No tax is complete nor a charge can rise under a fiscal statute unless the subject, the object and the quantum of tax are prescribed or indicated in the provision. In doing so, there can be different rates of tax levied upon the nature of business/profession carried on or depending on the capacity of the person to pay the tax and/or other relevant consideration. It is now well settled that a modern State, particularly when exercising powers of taxation, has to deal with complex factors/relating to the objects to be taxed, tax to be levied, the social and economic policies etc. Though wide latitude is given to the legislature in the matter of levy of taxes, what is needed is that the tax/ statute should be constitutionally valid to pass the muster of Article 14 of the Constitution of India. Article 265 of the Constitution of India prescribes that "no tax shall be levied or collected except by authority". No income should be taxed presumptively. There is no equity about taxation and no income should be taxed twice.

TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

In India the tax laws are admittedly complicated because of various deductions, exemptions, relief and rebates. Therefore, it is only logical that taxpayers generally plan their affairs so as to attract the least incidence of tax. However, practice of avoidance is worldwide phenomenon and there is always a continuing battle in this regard between the taxpayer and the tax collector. The perceptions of both are different. The taxpayer spares no efforts in maximising his profits and attracting the least incidence. The tax gatherer, on the other hand, tries to break the plans whose sole objective is to save taxes.

TAX PRACTICES

In the context of saving tax, there are three commonly used practices, namely (a) Tax Evasion; (b) Tax Avoidance;
(c) Tax Planning. They are being considered in greater details in subsequent discussion.

(a) TAX EVASION

It refers to a situation where a person tries to reduce his tax liability by deliberately suppressing the income or by inflating the expenditure showing the income lower than the actual income and resorting to various types of deliberate manipulations. An assessee guilty of tax evasion is punishable under the relevant laws. Tax evasion may involve stating an untrue statement knowingly, submitting misleading documents, suppression of facts, not maintaining proper accounts of income earned (if required under the law) omission of material facts in assessments. An assessee who dishonestly claims the benefit under the statute by making false statements, would be guilty of tax evasion.

Tax evasion is a method of evading tax liability by dishonest means like suppression, showing lower incomes, conscious violation of rules, inflation of expenses etc. This device has to be condemned. It is a dubious way of attempting to get tax gains. A tax evader has to pay not only penalty but he also incurs the risk of being prosecuted. Tax evasion can never be construed as tax planning because it amounts to breaking of law whereas tax planning is devised within the legal framework by availing of what the legislature provides. Tax planning ensures not only accrual of tax benefits within the four corners of law but it also ensures that tax obligations are properly discharged so as to avoid penal provisions.

(b) TAX AVOIDANCE

The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of malafide motive involved in tax avoidance also. Any planning which, though done strictly according to legal requirements defeats the basic intention of the Legislature behind the statute could be termed as instance of tax avoidance. It is usually done by adjusting the affairs in such a manner that there is no infringement of taxation laws and by taking full advantage of the loopholes therein so as to attract the least incidence of tax. Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations. In the judgement of the Supreme Court in McDowell's case 1985 (154 ITR 148) SC, tax avoidance has been considered as heinous as tax evasion and a crime against society. Most of the amendments are now aimed at curbing practice of avoidance.

The types of cases that come under 'Tax avoidance' are those where the tax payer has apparently circumvented the law, without giving rise to an offence, by the use of a scheme, arrangement or device though of a complex nature, whose main or sole purpose is to defer, reduce or completely avoid the tax payable under the law. Sometimes, the avoidance is accomplished by shifting the liability for tax to other person not at arm's length in whose hands the tax payable is reduced or eliminated. According to G.S.A. Wheat Craft, "tax avoidance is the act of dodging tax without actually breaking the law". It is a method of

reducing incidence of tax by taking advantages of certain loopholes of tax laws. Thus, the line of demarcation between tax avoidance and tax planning is very thin and blurred. There is an element of malafide motive involved in tax avoidance.

The Royal Commission on Taxation for Canada has explained the concept of tax avoidance as under :

For our purposes the expression "Tax Avoidance" will be used to describe every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provisions or lack of provisions of law. It excludes fraud, concealment or other illegal measures".

(c) TAX PLANNING

It means arranging the financial activities in such a way that maximum tax benefits are enjoyed by making use of all beneficial provisions in the tax laws which entitle the assessee to get certain rebates and reliefs. This is permitted and not frowned upon by law. Thus, tax planning would imply compliance with the taxation provisions in such a manner that full advantage is taken of all tax exemptions, deductions, concessions, rebates and reliefs permissible under the Income Tax Act so that the incidence of tax is the least.

Tax planning can neither be equated to tax evasion nor to tax avoidance with reference to a person, it is the scientific planning of the person's operations in such a way so as to attract minimum liability to tax or postponement or for that matter deferment of the tax liability for the subsequent period by availing various incentives, concessions, allowances, rebates and relief's provided for in the tax laws. They are meant to be availed of and they have certain clear objectives to achieve.

Tax planning may, therefore, be regarded as a method of intelligent application of expert knowledge of planning

a person's affairs with a view to securing consciously provided tax benefits on the basis of the national priorities

in consonance with the interests of the State and the public. Therefore, notwithstanding the legal rulings in cases like McDowell and its English parallels, real and genuine transactions aimed at a valid tax planning cannot be turned down merely on grounds of reduction of the tax burden.

While planning a scheme relating to tax affairs, what needs to be assured is that tax planning device does not lose its efficiency due to changes in law. It would be a shortsighted perspective to think of a planning device that is in conformity with the law as it exists, but gets nullified by a subsequent change in law specially where the change is of a retrospective nature. Hence, the tax plan has to be flexible in nature. Flexibility has to be considered as a practical feature in a tax system. Hence, a planner has to comprehend about the future scenario too while devising a plan to save tax.

In the context of corporate taxation since the incidence of tax on Indian companies is considered quite high

the scope for ploughing back of profits for expansion and modernisation of the existing plant and machinery etc. is considerably narrowed down. Thus the company has to plan its taxation in such a way that will enable

it to avail the tax incentives etc. provided by the Government to the maximum.

OBJECTIVES OF TAX PLANNING

Tax planning, in fact, is an honest and rightful approach to the attainment of maximum benefits of the taxation laws within their framework. Therefore, the objectives of tax planning cannot be regarded as offending any concept of the taxation laws and subjected to reprehension of reducing the inflow of revenue to the Government's coffers, so long as the tax planning measures are in conformity with the statute laws and the judicial expositions thereof. The basic objectives of tax planning are:

(a) Reduction of tax liability
(b) Minimisation of litigation
(c) Productive investment
(d) Healthy growth of economy
(e) Economic stability

(a) Reduction of tax liability

In this context, a tax payer can derive the maximum savings by arranging his affairs in accordance with the requirements of law, as contained in the fiscal statutes. In many a cases, a taxpayer may suffer heavy taxation not on account of the dosage of tax administered by the Act, but, because of his lack of awareness of the legal requirements. Since every taxpayer wishes to retain a maximum part of his earnings, rather than parting with it and facing the resource crunch, it would be to his benefit to plan his tax affairs properly and avail the deductions and exemption admissible under the Act (s). He can succeed in doing so by keeping an awareness of the implications of the various business/other transactions as well as updation of his knowledge about the various concessions for which he is eligible.

(b) Minimisation of litigation

A general visualisation of the tax administration scenario depicts a tug-of-war the tax payers trying their maximum to pay the least tax and the tax administrator attempting to extract the maximum. This also results in, sometimes, protracted litigations. It is in this context that a sound tax planning pays dividends. Where a proper tax planning is adopted by the tax payer in conformity with the provisions of the taxation laws, the incidence of litigation is minimised. This saves him from the hardships and inconveniences caused by the unnecessary litigations, which at times even stretch upto the High/Supreme Court levels':

(c) Productive Investment

Channelisation, by a tax payer, of his otherwise taxable income to the various investment schemes too is one of the prime objectives of tax planning as it is aimed to attain twin-objectives : (i) to harness the resources for socially productive projects, and, (ii) to relieve the tax payer not only from the initial brunt of taxation, but also to convert the earnings so made into means of further earnings. Legal awareness of the avenues so provided by the Government, from time to time, negates the imperative avoidance/evasion ends lend authenticity to the investments made.

(d) Healthy Growth of Economy

The growth of a nation's economy is synonymous with the growth and prosperity of its citizens. In this context, a saving of earnings by legally sanctioned devices fosters the growth of both, because savings by dubious means lead to generation of black money, the evils of which are obvious. Conversely, tax-planning measures are aimed at generating white money having a free flow and generation without reservations for the overall progress of the nation. Tax planning assumes a great significance in this context.

(e) Economic Stability

In the context of the case, M.V.Valliapan v. ITO, (1988) 170 ITR 238 (Mad.), by a proper tax planning, a smooth
tax flow from the tax payer to the tax administrator, without recriminations, is ensured. This results in economic stability by way of:
(i) availing of avenues for productive investments by the tax payers and,
(ii) harnessing of resources for national projects aimed at general prosperity of the national economy and reaping of benefits even by those not liable to pay tax on their incomes.

IMPORTANCE OF TAX PLANNING

We cannot deny the fact that tax planning is important for reducing the tax liability. It is also considered mportant on account of the following factors :

(i) When an assessee has not claimed all the deductions and relief, before the assessment is completed, he is not allowed to claim them at that the time of appeal. It was held in CIT v. Gurjargravures Ltd. (1972) 84 ITR 723 that if there is no tax planning and there are lapses on the part of the assessee, the benefit would be the least.

(ii) Tax planning exercise is more reliable since the Companies Act, 1956 and other allied laws narrow down the scope for tax evasion and tax avoidance techniques, driving a taxpayer to a situation where he will be subjected to severe penal consequences.

(iii) Presently, companies are supposed to promote those activities and programmes, which are of public interest and good for a civilised society. In order to encourage these, the Government has provided them with incentives in the tax laws. Hence a planner has to be well versed with the law concerning incentives.

(iv) With increase in profits, the quantum of corporate tax also increases and it necessitates the devotion of adequate time on tax planning.

(v) Tax planning enables a company to bear the burden of both direct and indirect taxation during inflation. It enables companies to make proper expense planning, capital budget planning, sales promotion planning etc.

(vi) Repairs, renewals, modernisation and replacement of plant and machinery are indispensable for an industry for its continuous growth. The need for capital formation in the corporate sector cannot be ignored and heavy taxation reduces the inflow of corporate funds. Capital formation helps in replacing the technologically obsolete and outdated plant and machinery and enables the carrying on of manufacturing operation with a new and more sophisticated system. Any decision of this kind would involve huge capital expenditure which is financed generally by ploughing back the profits, utilisation of reserves and

surplus along with the availing of deductions are revenue expenditure incurred for undertaking modernisation, replacement, repairs and renewal of plant and machinery etc. Availability of accumulated profits, reserves and surpluses and claiming such expenses as revenue expenditure are possible through proper implementation of tax planning techniques.

(vii) In these days of credit squeeze and dear money conditions, even a rupee of tax decently saved may be taken as an interest-free loan from the Government, which perhaps, an assessee need not repay. Thus, any legitimate step taken by an assessee (being a company) directed towards maximising tax benefits, keeping in view the intention of law, will not only help it but also the society since it promotes the spirit behind the legal provisions. All those companies which practice tax planning may have the satisfaction that they are contributing their best to the nation's broad objectives and goals in a welfare State like ours. At the same time, the law makes the fulfillment of certain conditions obligatory before allowing the benefits to be claimed by the companies. In this way, the companies, besides helping themselves, also help in securing the objectives, tasks and goals set before them by the country.

DIVERSION OF INCOME AND APPLICATION OF INCOME

The Supreme Court's verdict in CIT v. Sitaldas Tirthdas (1961) 41 ITR 367 is the authority for the proposition that where by an obligation income is diverted before it reaches the assessee, it is deductible from his income as for all practical purposes it is not his income at all but where the income is required to be applied to discharge an
obligation after it reaches the assessee, it is not deductible. Thus, there is the difference between diversion of income by an overriding title and application of income as the former is deductible while the latter is not. Thus, when management of a company is taken over by another person from the existing team in consideration of percentage of future profits to the latter, in computing the business income of the former, such percentage of profits is deductible [CIT v. Travancore Sugars and Chemicals Ltd. (1973) 88 ITR 1 (SC). Management agreements must therefore be drafted with caution.

The Delhi High Court's verdict in CIT v. Stellar Investments Ltd. (1991) 192 ITR 287 to the effect that the Assessing Officer in terms of the power available to him under Section 68 of the Act, is not precluded from ascertaining the genuineness of the share capital, must be needed. There have been occasions when unscrupulous promoters have ploughed back their black money into new companies by subscribing to shares in thousands of fictitious names. If the bluff is called, the unexplained credit in the form of share capital would be treated as income under Section 68 of the Act.

ESSENTIALS OF TAX PLANNING

Successful tax planning techniques should have following attributes :

(a) IT should be based on upto date knowledge of tax laws. Not only is an uptodate knowledge of the statute law necessary, assessee must also be aware of judgments made through various decisions of the courts. In

addition, one must keep track of the circulars, notifications, clarifications and Administrative instructions issued by the CBDT from time to time.
(b) The disclosure of all material information and furnishing the same to the income-tax department is an absolute pre-requisite of tax planning as concealment in any form would attract the penalty clauses – the penalty often ranging from 100 to 300% of the amount of tax sought to be evaded. Section 271(1)(c) read together with explanations there to.
(c) Whatever is planned should not simply satisfy the requirements of law by complying with legal provisions as stated and meeting the tax obligations but also should be within the framework of law. It means that sham transactions or make-believe transactions or colourable devices, which are entered into just with a view to circumvent the legal provisions, must be avoided.
Every citizen is obliged to honestly pay the taxes. Therefore, only colourable devices resorted to by the tax payers for evading a tax liability will have to be ignored by the court. Accordingly, a tax planning within the four corners of the taxation laws is not to be turned down only because it legitimately reduces the tax inflow to the Government. A genuine tax-planning device, aimed at carrying out the rules of law and Court's decisions and to overcome heavy burden of taxation, is fully valid.
(d) A planning model must be capable of attainment of the desired objectives of a business and be amenable to its possible future changes. Therefore, all the important areas of corporate planning, whether related to strategic planning, project planning or operational planning involving tax considerations for long-term or short-term management objectives and policies should be strictly scrutinised in relative situations. Foresight is the essence of a business. Tax planning is one of its important attributes.

TYPES OF TAX PLANNING

The tax planning exercise ranges from devising a model for specific transaction as well as for systematic corporate planning. These are:
(a) Short-range and long-range tax planning.
(b) Permissive tax planning.
(c) Purposive tax planning.

(a) Short-range planning & Long-range planning

Short-range planning refers to year to year planning to achieve some specific or limited objective. For example, an individual assessee whose income is likely to register unusual growth in particular year as compared to the preceding year, may plan to subscribe to the PPF/NSC's within the prescribed limits in order to enjoy substantive tax relief. By investing in such a way, he is not making permanent commitment but is substantially saving in the tax. It is one of the examples of short-range planning.
Long-range planning on the other hand, involves entering into activities, which may not pay-off immediately. For example, when an assessee transfers his equity shares to his minor son he knows that the Income from the shares will be clubbed with his own income. But clubbing would also cease after minor attains majority.

(b) Permissive tax planning

Permissive tax planning is tax planning under the express provisions of tax laws. Tax laws of our country offer many exemptions and incentives.

(c) Purposive tax planning

Purposive tax planning is based on the measures which circumvent the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction. For example, under Sections 60 to 65 of the Income-tax Act, 1961 the income of the other persons is clubbed in the income of the assessee. If the assessee is in a position to plan in such a way that these provisions do not get attracted, Such a plan would work in favour of the tax payer because it would increase his disposable resources. Such a tax plan could be termed as 'Purposive Tax Planning'.

AREAS OF TAX PLANNING IN THE CONTEXT OF INCOME TAX ACT, 1961

Some of the important areas where planning can be attempted in an organised manner are as under:

(a) Form of organisation/ownership pattern;
(b) Locational aspects;
(c) Nature of business.
(d) Tax planning in respect of corporate restructuring;
(e) Tax planning in respect of financial management;
(f) Tax planning in respect of employees remunerations;
(g) Tax planning in respect of specific managerial decisions;
(h) Tax planning in respect of Non-Residents.

FORM OF THE ORGANISATION

We have indicated above some of the important areas where tax planning can be attempted. In this Unit we shall discuss the first aspect of setting up of new business entity, namely form of organisation/ownership pattern. The selection of particular form of organisation depends not only on the magnitude of financial requirements and owner's liability, but also on the tax considerations. In the case of a company, the law interferes with the corporate planning process from the moment it comes into existence. At times, tax laws affect even the periods prior to the existence of a company and it can also extend upto the point of time when the company ceases to exist. For example, a director of a private limited company in liquidation, has to keep in view the provisions of Sections 178 and 179 of the Income Tax Act, 1961 dealing with misfeasance etc. Normally, depending upon the level of operation, expected profitability need for external financing and expected requirements of technical expertise, a suitable form can be chosen. But in view of the continuity of business, the benefits arising out of limited liability,

organised accounting and the overall long-term tax benefits flowing to the company form of organisation, the corporate enterprise may be regarded as an effective instrument of tax planning. The company being a separate legal entity, confers certain valuable benefits in the matter of tax planning to its shareholders and the persons connected with the management of the company.

Tax liability is an important consideration guiding the choice of a legal form of business organisation. In some circumstances however this consideration is of no significance. For example large business is generally compelled to organise itself in the form of a company as this form of organisation makes it possible to raise large amounts of capital required. Similarly retail business of small size can only be economically operated as proprietorship or partnership firm. When there is freedom of choice taxation becomes an important consideration.

(A) Company Form of Organisation

The important tax privileges and advantages to a company over the other forms can be summarized as under:

(i) Allowability of remuneration, for the persons who are managing the affairs of the company and also owning its shares.

(ii) The provisions relating to clubbing of income under Section 64 of the Income Tax Act, 1961 do not apply

even if the business is carried on by family members through a company, which ultimately leads to reduction in liability to tax on the part of the individual members. However, if spouse of an individual having a substantial interest in a company receives remuneration from the same company, such remuneration is added to the income of the individual unless the spouse is technically or professionally qualified. [Section 40A(2)(b) of the Income Tax Act, 1961].

(iii) Any income by way of dividend referred to in Section 115-O is exempt under Section 10(34). (iv) Companies are subjected to flat rate of tax, regardless of the quantum of their income. The domestic companies now pay tax @ 30% plus surcharge @ 5% (surcharge is applicable if their total income exceeds ` 1 Crore), if applicable and education cess @ 3%.. This, however, may not seem to be an advantage in view of low slab rates applicable to sole proprietorships, but when we look at the total incidence of tax after taking into account the various deductions allowed to companies and the scheme of perquisites, the real owners of companies stand to benefit.

(v) There are certain special tax concessions, allowances and deductions given under the Income Tax Act, 1961 available to the company form of business enterprises such as deductions allowed under Section 33AC and Sections 36(1)(ix) and 35D of the Income Tax Act, 1961 etc.

(vi) Incorporation of a company has the incidental advantage of attracting large capital since the shareholder, who has to contribute only a miniscule part of the capital requirements, is assured of limited liability and free transferability of his shares. That shares in companies are treated as long term capital assets qualifying for considerable leniency in taxation even if they are held by the assessee for a small time as 12 months, has made investment in the shares of companies all the more attractive. This helps the companies to generate the funds required for their development as well as furtherance of their objects.

(vii) There is no wealth tax on shares of company w. e. f. Assessment Year 1993-94. In case there is every likelihood of growth of business in future years a partnership firm or sole proprietorship business may be formed initially and may be converted into a company later, on growth of

business as the average rate of tax applicable for non-corporate assessee is less than the flat rate applicable to corporate assessees.

The relative tax burden of conducting business can be assessed by paying attention to the provisions of the Income-tax Act, 1961, Income-tax Rules, 1962 and various other notifications and circulars issued from time to

time by concerned authorities.

An individual pays tax on his income on the basis of slab system. He gets the benefit of minimum taxable limit

laid down by the respective Finance Acts. Income received by an individual in different capacities, i.e. as a member of a firm is not taxable in hand of partner. Because firm has paid tax on it. The owner of a proprietorship firm is treated as an individual for tax purposes.

A company is regarded as a separate legal entity. The minimum limit does not apply in its case. It is required to pay tax on every rupee of its income. Besides the usual income tax at the flat rate prescribed by the respective Finance Acts, whatever amount of tax is paid by a company is not deemed to have been paid on behalf of the shareholders. Therefore, no rebate is allowed to shareholders in this regard as is the practice in advanced countries.

(B) Partnership Firm or Limited liability Partnership

A partnership form of organization is easy to establish. The only procedure for the formation of partnership is to draw up a partnership deed and a nominal charge in terms of cost of stamps for the deed is to be incurred. This form of organization is suitable due to the following factors:

– The decision making on important business matter is quick as compared to a company form of organization because partners meet frequently together. Therefore, decision on any important business matter cannot be delayed.

– The chance of getting involved in risky activities is very less because every important decision is made with the concurrence of all the partners.

– As compared to sole proprietorship, the problem of raising additional resources is much less. Whenever the business expands and it is necessary to raise finance, it will be easy to raise it by admitting a new partner or raising it by way of borrowings because of number of partners and their joint and several liability to pay the debts of the firm, the lenders will be more interested in lending.

– The firm can pay interest on capital and loan to partners at the maximum rate of 12% p.a. Further it can also give remuneration to its working partners subject to the limits mentioned in Section 40(b).

– This form of organisation is suitable from income-tax point of view in such cases where the amount of profit is not large and the partners of the firm do not have any other additional income except by way of remuneration and interest from the partnership firm. In such a case the profit of the firm shall be lower and the individual partners can also avail of the maximum ceiling of income exempt under the Income-tax Act. – The share in the profit of the partnership firm is exempt form tax under

Section 10(2A) of the Income-tax Act. – The risk as to losses and liability incurred is divided amongst the partners.
– As in the case of company form of organization where the change of business requires a long procedure, there is no tedious procedure in the partnership form of organization. The business can be changed only with the consent of partners.
– The firm is taxable at a flat rate of 30% + education cess @2% + SHEC @1% for assessment year 2014-15 after allowing interest and remuneration to working partners (if provided in the partnership deed and subject to Section 40(b) of the Income-tax Act.

However this form of organization is not suitable due to the following reasons:

1. The risk taking capacity of the partners becomes limited. Every decision relating to important business matters is made with the consultation of other partners, which restricts the risk taking activities which may yield much higher profits.
2. As far as the operations of business are limited to small or medium scale, there is no problem in financing the expansion of business operation. But when business gets expanded to a large scale, then it will be suitable to adopt a company form of organization because partnership can be formed up to maximum number of 20 partners.
3. One of the main drawbacks is that one partner becomes liable for the acts of another. Therefore, a partner is liable for the wrongs of another partner if it is done within the legal limits.
4. In the new scheme of assessment of partnership firms, the share of partners is exempt from tax under Section 10(2A) but the partners remuneration and interest, subject to limit mentioned in Section 40(b), is taxable in the hands of the partners under the head profits and gains of business or profession. Also, the firm cannot claim deduction in respect of interest payable to partners in excess of 12% per annum.
5. Where the partnership firm does not comply with the requirements of Section 184 of the Income Tax Act, although the firm shall be assessed as firm, it shall not be allowed any deduction on account of interest and remuneration to its partners.
6. A partnership firm may come to a sudden closure of business on account of death, lunacy or insolvency. In the case of a business running efficiently and profitably, such as happening will cause a great loss. Also, dissolution will attract Section 45(4) which imposes tax liability in respect of capital gain arising on transfer of capital assets from the firms to partners.

Entrepreneurs now have an alternative and innovative form of business organization i.e. Limited Liability Partnership (LLP) which combines the benefits of company and general partnership form of business organizations. LLP has separate legal entity, perpetual succession and limited liability of partners. From income tax point of view it is treated same as general partnership firm therefore its profits will be taxed in the hands of the LLP not in the hands of its partners.

(C) Sole proprietorship

The most common form of ownership found in the business world is sole proprietorship. In this form of organization, the proprietor is the only

owner of the business assesed and he is solely responsible for the affairs of the business.
– A sole proprietorship is easy to establish because of little interference of government regulations.
– The cost of adopting this form of organization is small because of there being no legal requirement.
– All the profits of the business go in the hands of proprietor himself.
– In case of persons carrying on business on small scale and having small income from other sources, this form of organization would be suitable because the proprietor can avail of the ceiling of exempt income as under:
For assessment year 2014-15:
(a) in case of individuals in India below 60 years of age. 2,00,000
(b) in case of individual resident in India who is of the age of 60 years or 2,50,000
but below the age of 80 years at any time during the previous year
(c) in case individual who is the age of 80 years or above 5,00,000
The tax liability of the individual will be minimum as the individual is subject to income-tax at slab rate
and the maximum marginal rate of income-tax in his case is 30% plus education cess @2% plus SHEC
@1% for the assessment year 2014-15.
– Besides the deductions which are allowed to all assesses under Chapter VIA, a sole proprietor, being
assessed as individual, is entitled to get certain deductions under the following sections:
(i) Section 80C relating to contributions to provident fund, life insurance premium, subscription to certain equity shares or debentures, etc.
(ii) Section 80CCC relating to contribution to certain pension funds.
(iii) Section 80CCD relating to contribution to notified pension scheme of the Central Government.
(iv) Section 80D relating to medical insurance premia.
(v) Section 80DD relating to maintenance of a dependent who is a person with disability.
(vi) Section 80DDB relating to expenditure on medical treatment, etc.
(vii) Section 80E relating to interest taken for higher education.
(viii) Section 80GG relating to rent paid.
(ix) Section 80QQB relating to royalty income, etc. of authors of certain books other than text books.
(x) Section 80RRB relating to royalty on patents.
(xi) Section 80U relating to persons with disability.
However, this form of organization is also not suitable due to:
– The liability of the proprietor is unlimited and it can extend even to his personal assets. When the proprietor incurs losses and business assets are not sufficient enough to meet the liabilities of business, his personal assets can be used for discharging the business liabilities.
– The proprietor does not get deduction on account of remuneration payable to him attributable to the rendering of services. It is felt that it is the capital contributed and risk taken by the proprietor for which he is rewarded in profits and that he must be given remuneration for the

service rendered by him which should be allowed as deductible expenditure. But this is not so in income-tax law.

– Another main drawback of this form of organization is that it does not provide opportunities to finance the expanding business activities. In the case of a partnership firm, on the other hand, finance can be raised by the existing partners or by entering another partner.

(D) Hindu Undivided Family

A joint Hindu family pays tax on its total income at prescribed rates on the basis of slab system. The family can pay reasonable remuneration to the Karta and other family members for their services to the business and it is allowed as a deduction in computing the business income. However, interest on capital contributed by the family for the business is not deductible in computing business income. The member of the family, who has received the remuneration from the family will include it in his income under the head Salaries.

A Hindu undivided family will also get a basic exemption of ` 2,00,000 from assessment year 2013-14. Besides the deductions which are allowed to all assesses, it is allowed certain deductions under Sections 80C, 80D, 80DD, 80DDB and 80GG like individuals. The tax rates in case of HUF are same as applicable to individual. The demerits of HUF, however, are similar to that of individuals.

LOCATIONAL ASPECTS

Tax planning is relevant from location point of view. There are certain locations which are given special tax treatment. Some of these are as under:

1. Full exemption under Section 10A for ten years in the case of a newly established industrial undertaking in free trade zones, etc. [Not allowed w.e.f. A.Y. 2012-13].
2. Full exemption under Section 10AA for initial five years, 50% for subsequent five years and further deduction of 50% for a further period of five years in the case of a newly established units in special economic zones on or after 1.4.2005.
3. Full exemption under Section 10B for 10 years in the case of a newly established 100% export-oriented undertaking. [Not allowed w.e.f. 2012-13].
4. Deduction under Section 80-IAB in respect of profits and gains by an undertaking or an enterprise engaged in the development of Special Economic Zone.
5. Deduction under Section 80-IB in the case of newly set up industrial undertaking in an industrially backward State or district.
6. Deduction under Section 80-IC in case of newly set up industrial undertaking or substantial expansion of an existing undertaking in certain special category States.
7. Deduction under Section 80-ID in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site.
8. Deduction under Section 80-IE in respect of certain undertakings in North-Eastern States.

NATURE OF BUSINESS

Tax planning is also relevant while deciding upon the nature of business. There are certain businesses which are granted special tax treatment. Some of them are as follows:

– Newly established industrial undertaking in free trade zones, etc. [Section 10A]. [Not allowed w.e.f. A.Y. 2012-13].
– Newly established units in special economic zones [Section 10AA].
– Newly established hundred per cent export-oriented undertakings [Section 10B]. [Not allowed w.e.f. A.Y. 2012-13].
– Tea Development Account, Coffee Development Account and Rubber Development Account [Section 33AB].
– Site restoration fund [Section 33ABA].
– Specified business eligible for deduction of Capital Expenditure [Section 35AD].
– Amortisation of certain preliminary expenses [Section 35D].
– Expenditure on prospecting for certain minerals [Section 35E].
– Special reserve created by a financial corporation under Section 36(1)(viii).
– Special provision for deduction in the case of business for prospecting for mineral oil [Sections 42 and 44BB].
– Special provisions for computing profits and gains of business on presumptive basis [Section 44AD].
– Special provisions in the case of business of plying, hiring or leasing goods carriages [Section 44AE].
– Special provisions in the case of shipping business in the case of non-residents [Section 44B].
– Special provisions in the case of business of operation of aircraft [Section 44BBA].
– Special provisions in the case of certain turnkey power projects [Section 44BBB].
– Special provisions in the case of royalty income of foreign companies [Section 44D].
– Special provisions in case of royalty income of non-residents [Section 44DA].
– Certain income of offshore Banking Units and international Financial Service Centre [Section 80-LA].
– Profit and gains of industrial undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA].
– Profits and gains of an undertaking or an enterprise engaged in development of Special Economic Zone. [Section 80-IAB].
– Profits and gains from certain industrial undertaking other than infrastructure development undertaking [Section 80-IB].
– Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC].
– Deduction in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site. [Section 80-ID].
– Special provisions in respect of certain undertakings in North-Eastern States. [Section 80-IE].

– Profits and gains from the business of collecting and processing of bio-degradable waste [Section 80JJA].
– Employment of new workmen [Section 80JJAA].
– Special tax rate under Sections 115A, 115AB, 115AC, 115AD, 115B, 115BB, 115BA and 115D.

TAX PLANNING RELATING TO CORPORATE RESTRUCTURING

The following suggestions could be useful for tax planning in respect of amalgamation merger, demerger, etc.

1. Since the unabsorbed losses and unabsorbed depreciation cannot be allowed to be carried forward and set off in the hands of the amalgamated company, except in the cases prescribed under Section 72A of the Act, it is proposed:

(a) that the scheme of the amalgamation can be put off till such time the full benefit of set off is availed of by the amalgamating company; and

(b) that the loss carrying company should absorb or take over the business of the profit-making company. In other words, the profit making company should merge itself with the loss incurring company. This would help in carrying to carry forward the benefits of all unabsorbed losses and depreciation to be set off against the profits derived from the business of the profit-making company.

2. To save from disallowance of the debts of the amalgamating company which subsequently become bad in the hands of the amalgamated company, the amalgamated company should plan to make suitable provision for the expected losses on account of bad debts at the time of fixing the consideration while taking over the business of the amalgamating company.

However, in view of the Court judgment of CIT v. T. Veerabhadra Rao (1985) 22 Taxmann 45, the bad debts are not allowed to an assessee by way of personal relief but to a business. So, it is possible for the amalgamated company to claim bad debts even in respect of debts taken over from the amalgamating company.

3. A company whose shares are not quoted on a recognised stock exchange may avail the benefit of amalgamation by amalgamating itself with another company whose shares are quoted on a recognised stock exchange. This would help its shareholders to take the advantage of the quoted price of their shares in the stock exchange.

4. A company holding investments in immovable properties may avail the benefit of non-applicability of the provisions of the Urban Land Ceiling Act by amalgamating itself with an industrial company.

5. A loss incurring company and a profit-making company may merge in order to reduce the overall incidence of liabilities to tax under the Income Tax Act, 1961.

6. In case the conditions provided under Sections 2(1B) and 72A of the Act are not satisfied, it may be suggested that the profit making company should merge itself with the loss making company, so that the loss making company does not lose its existence and also enjoys all other benefits.

7. Under Section 2(1B) of the Act, it is provided that for availing the benefits of amalgamation, at least 75% of the shareholders of the

amalgamating company should become shareholders of the amalgamated company. In case more than 25% of the shareholders are not willing to become shareholders of the amalgamated company, it is proposed that the amalgamating company may persuade the other shareholders who may be willing, to purchase the shares in the amalgamated company to acquire the shares of the remaining shareholders so that the percentage of dissenting shareholders does not exceed 25%. Alternatively, the amalgamated company prior to, amalgamation, may purchase shares from such dissenting shareholders so as to make such dissenting shareholders to go below the specified percentage of 25%.

There is a recent trend of going in for reverse merger. It means that the profit making company merges into the sick company thereby becoming eligible to carry forward of losses etc. without the aid of Section 72A of the Act. The profit making or healthy company extinct and loose its name and the surviving sick company retains its

name. It is actually device to bypassing merger under Section 72A of the Act and is being increasingly popular now a days. Invariably soon after the merger or after a year or so, the name of the company is changed to accord with that of the profit making amalgamating company in this way two birds are killed with one stone because : (1) Losses are carried forward, which would otherwise have not been possible; (2) Goodwill, which consists, in the name of the profit making amalgamating company, is also retained. The same route was followed, among others, by Kirloskar Pneumatics Ltd. where the company merged with Kirloskar Tractors Ltd., a sick unit and initially lost its name but after one year it changed its name as was prior to merger. However, it remains to be seen whether the Parliament/Judiciary views this kind of strategy as an exercise resulting in tax-avoidance or not? But, right now, this is not required in view of changes done in Section 2(1B) and 72A of the Act.

TAX PLANNING RELATING TO FINANCIAL MANAGEMENT DECISIONS

When a company raises long term loans from financial institutions or by way of public issue of debentures or inviting deposits from the public, it should plan that the expenses incurred on such issues of debentures or expenses towards stamp duty, registration fees, and lawyer’s fees should be incurred only after the date of the ‘setting-up’ of the business. The interest paid before the commencement of production but after setting up of the business on loans taken by the company for the acquisition of its plant and machinery and other assets, forms part of the actual cost of the asset and it should be capitalized in actual cost of asset. Thus, the company would be allowed to capitalise the expenditure and claim a higher depreciation and investment allowance.

The company should also plan the optimum use of the share capital and the borrowed funds. Note that the borrowings should be utilised as far as possible for the acquisition and installation of assets like, buildings, plant and machinery so that interest can be capitalised for the period after setting up of the acquired assets like buildings, plant and machinery but before the commencement of production. The interest and higher amount of depreciation (due to capitalisation of expense) may be claimed as revenue expenditure pertaining to the business of the company.

The company should also plan to purchase the depreciable assets on credit terms and an agreed amount of interest can be paid on such credit purchases or the company may purchase these company assets on the basis of the hire purchase agreement enabling the company to claim the amount of interest paid as revenue business expenditure. The company would also be entitled to claim either the depreciation for use of the asset or may treat the hire charges as the rent for the asset in the normal course of business and claim deduction on revenue account.

The following table will help the finance manager framing suitable plans relating to capital structure:

Capital Borrowings

(a) Dividend/Interest Not deductible Fully deductible

(b) Cost of raising finance 1/5th allowed under Section 35D Fully deductible in first year.

Taking the same sources of finance, the comparison between pre-commencement period and postcommencement period is as follows :

(a) (i) Dividend is not deductible either for pre-commencement period or in the post-commencement period in
India.

(ii) Interest is capitalised for pre-commencement period, i.e. added to the cost of project' (cost of fixed assets) and its depreciation is calculated on capitalised value of assets. In post-commencement period, interest is fully deductible.

(b) (i) Cost of raising finance in case of capital is not deductible as revenue expenditure but amortised under Section 35D of the Act. If such expenditure is incurred after the commencement of the business. Section 35D is applicable, provided the expenditure is undertaken for expansion purposes in case of industrial undertaking.

(ii) Cost of borrowing funds in case of pre-commencement period is capitalised and in case of postcommencement period, it is deductible fully in the year.

The above consideration will go a long way in suggesting the managements of corporate entities to adopt a suitable capital structure and selecting the appropriate financing sources by providing an optimum capital mix for the organization

TAX PLANNING RELATING TO NON-RESIDENTS

Suggested tax planning measures for Non-Resident are:

1. As a Non-resident is not required to pay tax on his income earned and received outside India, an Indian citizen having an assignment abroad could plan his visits to India in such a way so that he could remain to be a Non-Resident for the purpose of the Income Tax Act. This is generally of interest to persons employed in foreign countries.

2. All those dealing with Non-Residents must keep in view the provisions of Sections 162 and 163. They should retain sufficient amounts with them to be paid on behalf of the Non-Resident towards his tax liability, so that they are not obliged to pay such taxes on their own account. They should also keep in view the obligations cast by Section 200, of paying the taxes deducted within the time prescribed so as to avoid applicability of the prosecution provisions under Section 276B.

3. A Non-resident must be very clear as regards his tax liability through agent. He must be aware that the agent will deduct some amount out of the amount payable to the Non-Resident.
4. Persons employed by or on behalf of a Non-Resident, those who have a business connection with Non- Resident and statutory agents are all considered as authorised agents of a Non-Resident. Even a Non-Resident could be treated as the agent of another Non-Resident.
5. It should be remembered that if the agent is unable to recover from the Non-Resident the amount of tax paid on his behalf, he cannot claim it as a bad debt or as business loss in view of Supreme Court decision in CIT v. Abdullabhai Abdhulkadar (1961 41 ITR 545).
6. Another very important point is the close financial association between a resident and a Non-Resident. This can also amount to a business connection. In a case where all Indian Banks and a foreign bank were controlled by the same persons and the main function of the foreign bank was to finance the Indian Bank, it was held that a business connection existed in India between the two banks, Bank of Chettinad Ltd. v. CIT Madras (PC) (1940) 8 ITR 522.
7. When an individual, being a citizen of India leaves India for purposes of employment, the new explanation under Section 6(1)(c) mitigates the rigor of the provisions about treating a person as resident and ordinarily resident. Under clause (c), an individual is said to be resident in India in any previous year if having been in India for at least 365 days during the four preceding years, he is in India for 60 days in that year. Clause (a) of the new explanation provides that where an individual citizen leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of Section 3 of the Merchant Shipping Act, 1958 (44 of 1958); or for purpose of employment outside India, the period of 60 days will be substituted by 182 days. Likewise, clause (b) provides that where an Indian citizen or a person of Indian origin within the meaning of Explanation to Clause (e) of Section 115C who is outside India comes on a visit to India in, the previous year, the period of 60 days referred to in sub-clause (c) will be substituted by 182 days. Thus, they will be Non-Resident in India for that year and as a result salary income earned abroad will not be taxed in India. They may visit India during vacation for 181 days or less, or else if he desires to stay in India for a period longer than 181 days the visit should be so planned over two previous years that his total stay in any one previous year should remain 181 days or less. In this way they can stay upto 362 days (181 days in one financial year and 181 days in another financial year) at a stretch without becoming resident in any of the two previous years.
Explanation to Section 6(1)(c) had been substituted by Direct Tax Laws (Second Amendment) Act, 1989 and subsequently amended by the Finance Act, 1990 with effect from 1.4.1990 i.e. for and from the assessment year 1990-91. Under the substituted Explanation, it is. provided that in the case of an Individual:
(a) being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship as defined under Section 3(18) of the Merchant Shipping Act, 1958 (44 of 1958, or for the purposes of employment outside India, the provisions of Section 6(1)(c) shall apply

in relation to that year as if for the words 'sixty days', the words' 'one hundred and eighty two days' had been substituted.

(b) being a citizen of India, or a person of Indian origin within the meaning of Explanation to Section 115C(e) who being outside India, comes on a visit to India in any previous year, the provisions of Section 6(1)(c) shall apply in relation to that year as if for the words 'sixty days' occurring therein, the words 'one hundred and eighty two days' had been substituted.

TAX PLANNING FOR INDIAN COLLABORATORS

While entering into an agreement for foreign collaboration, the Indian collaborator should take into consideration such aspects as will enable him to plan his tax affairs in a manner that ensures maximum after-tax profits and return on investment. In this context, the Indian collaborator may be advised to adopt the following steps for tax planning:

(i) Capitalisation of installation expenses

As far as purchase of capital goods from the foreign collaborator is concerned, it is needless to say that this is a capital expenditure on which depreciation is admissible. But care should be taken to see that the cost of installation, including the supervision expenses charged by the collaborator, is also capitalised and depreciation claimed thereon, The Indian company should also be vigilant that the other expenses relating to the collaboration agreement must be incurred after the date of the setting up of the business, because only then it would be entitled to be capitalised as other expenses.

(ii) Treating purchase of spares as revenue expenditure

For the purchase of spares for the plant, the Indian collaborator should plan to receive the spares subsequent to
the year of commissioning of the plant and preferably execute a separate contract in this behalf. It will enable the Indian company to treat the whole of the amount of spares as revenue expenditure. In this context, the judgement of the Madras High Court in CIT v. Rama Sugar Mills Ltd. (1052) 21 ITR 191 (Mad.) is worth-noting. A sugar manufacturing company had three boilers at its factories. Two of these were constantly in use and the third one was kept as "spare" ready to be used when one of the other two boilers had to be cleaned up at intervals. The productive capacity of one of the boilers deteriorated and the company was required to purchase the other at a cost of ` 85,000. The Madras High Court held that this expenditure was deductible on revenue account, on the ground that "the boiler which was substituted was exactly similar to the old one and by this expenditure, the assessee company did not bring any additional advantage to the trade or business, which they were carrying on and there is no improvement. It cannot be suggested that by using a new boiler for an old one, the production capacity of the sugar manufacturing unit was in any manner increased".

(iii) Treating plans and drawings, etc. as "Plant for availing of full value as depreciation

ln view of the Supreme Court's decision in the case ClT v. Alps Theatre, (1067) 65 ITR T77 (S.C.) "Plant" includes ships, vehicles, books, scientific apparatus, and surgical equipments used for the purpose of business or profession. However, know how acquired on or after

1.4.1998, owned wholly or partly by the assessee and used by such assessee for the purpose of his business or profession, will form a separate block of asset alongwith other intangible asset and will be eligible for depreciation under section 32(1) @ 25% on written law value.

TAX PLANNING FOR EMPLOYEES

The employees should keep the following aspects in view while planning their salary package:

(i) The employee should opt for division of salary into basic pay and allowances and should not opt for the consolidated salary. This will minimise his tax incidence considerably as some of the allowances are exempt from tax upto a certain extent for e.g. conveyance allowance is exempt upto `800 p.m.

(ii) Under the terms of employment, dearness allowance should form part of the retirement benefits. This will not only increase the employees retirement benefits but also reduce his tax incidence in respect of HRA, gratuity, commuted pension, employer's contribution to RPF, etc.

(iii) Any commission payable as per the terms of employment should be based on turnover so as to form part of salary. This will also reduce the tax incidence in respect of HRA, commuted pension, interest credited to RPF, etc.

(iv) If the employee is allowed the use of more than one car for his private purposes, the horse power of any such car should not exceed 1.6 litre cubic capacity as otherwise he shall be deemed to have been provided with one car of 1.6 cubic litre capacity which would lead to higher valuation of such perquisite.

(v) The employer's contribution to RPF should be 12% of salary as it is exempt upto this limit.

(vi) The employee should opt for re-imbursement of expenses on medical treatment (on free medical facility)
in place of medical allowance because such allowance is taxable whereas the reimbursement is not taxable upto the extent of ` 15,000. The same thing holds good for entertainment allowance.

(vii) Perquisites should be preferred to taxable allowances. This shall help not only in lower valuation of a perquisite like rent free house but the employee will also be free from falling into the category of specified employees.

(viii) It may be noted that if furniture is provided without rent free accommodation, it will not be taxable in the hands of non-specified employees.

(ix) An employee who resigns before completing five years of continuous service in an organisation, should ensure that the new organisation he joins maintains RPF so that the accumulated balance of the provident fund could be transferred to the new organisation to claim exemption thereon.

(x) On retirement, the employee should opt for commuted pension to the maximum permissible limit as it is exempt from tax within certain limits.

(xi) Leave encashment should preferably be done on termination of employment by superannuation or otherwise as it will then be exempt from tax within certain limits.

In addition to the above, the employees should also plan for taking full advantage of the relevant provisions
under Section 80C to 80U of the Income Tax Act.

TAX PLANNING UNDER WEALTH TAX ACT

As measures of tax planning, companies can take the following precautions:

(a) As far as possible, companies should avoid to invest in taxable assets like, jewellery, motor cars, other unproductive assets etc.

(b) Alternatively, in unavoidable cases, the investment in the said assets could be made out of loan or a debt may be incurred in relation thereto, by way of furnishing a security for a loan. For example, companies generally finance the purchase of assets like, motor cars/trucks/vehicles etc., through bank loans/ overdrafts/mortgage.

(c) Likewise, purchase of a house property likely to be used by the Directors/ Manager/Secretary as their residential accommodation or by any other employee who has a substantial interest in the company (holding at least 10% equity shares of the company) could be funded out of loan/raising of debts thereon. The strategy will help the company to dilute the incidence of tax on its wealth.

CHARITABLE INSTITUTIONS

Associations having charitable object viz., promotion of commerce, art, science, religion, charity or any other useful object by nature, can be registered as companies under Section 25 of the Companies Act, 1956, and avail the benefits of a company form of organisation from the point of view of the Companies Act, as well as the various tax concessions available to widely-held companies under the Income tax Act and also claim exemption from, Wealth tax and total exemption from Income tax under Section 11 of the Income Tax Act subject to the conditions specified in Section 13 thereof.

LEGISLATIVE AMENDMENTS

It is a common feature of modern legislative system to lay down in the Acts, the principles and the policy of the
legislature leaving out details to be filled-in or worked-out by rules or regulations made either by the Government or by some other authority as may be empowered in the legislations. This kind of subordinate or administrative legislation is justified and even necessitated by the fact that the legislature has neither the time nor the material to consider and act with reference to various details. Not only that they may not be even acquainted fully with the facts and circumstances relating to the subject matter. Section 295(1) of the Income-tax Act and Section 46(1) of the Wealth Tax Act respectively vest in the Central Board of Direct Taxes the power to give retrospective effect to any of the rules in such a way as not to prejudicially affect the interest of the tax payers. The various matters in respect of which the rules may be framed are specified in the relevant sections. Section 119 read together with Section 295 empowers Central Board for Direct Taxes to frame rules, issue circulars, notifications, administrative instructions to the sub-ordinate authority for smooth functioning of the Income Tax Act, 1961. Section 119 read together with Section 295 gives general powers to Central Board for Direct Taxes to frame the rules and notifications. However, relevant

sections empower Central Board for Direct Taxes to frames rules and issue relevant notifications. For example, Section 44AA provides that certain persons carrying on profession or business such as legal, medical, architectural or interior decoration or the profession of accountancy or technical consultancy or any other profession as is notified by the Board. Therefore, on careful perusal of Section 44AA, it may be seen that this Section empowers Central Board for Direct Taxes to issue notification to the effect that other professions shall be covered by the provision of Section 44AA for maintenance of books of account.

STATUTORY FORCE OF THE NOTIFICATIONS

Section 296 of the Income Tax Act, 1961 provides that the Central Government shall cause every rule made under this Act or for that matter any notification issued, to place before both the Houses of Parliament either before issuing them or in case same is issued when Parliament is not in session immediately thereafter when the Houses are in session. Rules and notifications are made by the appropriate authority in exercise of the power conferred on it under the provisions of the Act. For the A.Y. 2008-09, notification includes every notification issued before the 1-6-07 under Section 10(23C)(iv). Therefore, they have statutory force and can be equated to the law made by the legislature itself. Thus, they are a part and parcel of the enactment. The rules cannot, however, take away what is expressly conferred by the Act. In other words, they cannot whittle down the effect of the law. The rules are only made in consonance with provisions of the Act. They must be interpreted in the light of the section under which they are made. If there is any irreconcilable conflict between a rule and a provision in the Act, the provision in the Act will prevail.

Notifications when validly made in exercise of the authority provided for in the law, are equally binding on all concerned and may be enforced. (As for press notes, although they have no statutory force as such, they are binding on the officers). Section 119(1) of the Income-tax Act provides that all officers and other persons employed in the execution of the said Act shall observe and follow the orders, instructions and directions of the Board, provided that such orders, instructions or directions shall be issued as not to interfere with the discretion of the Appellate Assistant Commissioner in the exercise of his appellate functions.

It is judicially settled that the circulars issued by the Board would be binding under Section 119 on all the officers and persons employed in the execution of the Act [Navnital Javeri v. Sen (1965) 56 ITR 198 (SC)]. If an Income Tax Officer contravenes any circular issued by the CBDT in any respect, he can be called-upon by the appropriate authority including the Commissioner/Commissioner (Appeals), and the Appellate Tribunal to give effect to it. Though the Circular is not the same footing as a rule, it can be taken judicial note of. However, it may be noted that an opinion expressed by the Board in individual communications to the assessee (for example, as to when the new industrial undertaking established by the assessee began to manufacture or produce articles within the meaning of Section 80(I) cannot be considered as directions binding on the income tax authorities under Section 119. The Board is

not competent to give directions where the exercise of any quasi judicial discretion by the subordinate authorities in individual cases is involved. [J.K. Synthetics Ltd. v. CBDT (1972) 83 ITR 335 (SC)]. It has been clarified by the Supreme Court in Kerala Financial Corporation v. CIT 210 ITR 129 that Section 119 does not empower the CBDT to issue order, instruction or direction overriding the provisions of the Act. That would be destructive of all known principles of law as the same would really amount to giving power to a delegated authority to even amend the provisions of law enacted by the Parliament. Under Section 119 CBDT also cannot issue order for a specific case.

Normally, exemptions should be specifically provided by the Statute giving exemptions. Where schedules and
notifications are issued as empowered by the statute, the exemptions given by the notification would be legally valid as if were given by the statute itself. In the case of Collector of Central Excise v. Parle Exports (P) Ltd. (1990, 183 ITR 624), the Supreme Court had held that when a notification is issued in accordance with powers conferred by the statute, it has statutory force and validity and therefore, it is as if the exemptions under the notification were contained in the Act itself.

The various judicial rulings point out the following:

(1) The instructions of the Board are binding on the Department but not on the assessee.

(2) The instructions have to be followed by the Departmental Officers. Instruction adverse to an assessee's interest can be challenged by him.

(3) The instructions withdrawn subsequently should be given effect to by the Assessing Officer for the assessment year for which they were in force even though they are withdrawn at the time he makes the assessment.

(4) In the exercise of its power, the Board cannot impose a burden or put the assessee in a worse position. In view of this position, the tax planner, while planning his affairs or that of his clients must take into account not only the relevant legal provisions which affect him but also all relevant rules, notifications, circulars etc. As for circulars, since they are in the nature of administrative or executive instructions, the possibility that they might be withdrawn by the Board at any time, should also be taken into account. They may be challenged in the courts although, otherwise, they are binding at the administrative level. In cases where the circulars are based on an erroneous or untenable footing, they are liable to be quashed by the courts.

ORGANISATION OF TAX PLANNING CELLS

Some companies can afford to have separate tax planning departments while others cannot. The need for having tax planning department does not depend upon the amount of tax liability of the company. In fact, in certain cases, companies having effective tax planning cells can plan their transactions with a view to attract the least incidence of tax Organisation of such a cell can be justified on the following grounds :

(a) Complexity and volume of work

Where the volume of tax work to be handled is large and highly complex, then it is required to appoint a special tax expert along with the required staff.

(b) Separate Documentation

Documentation is an indispensable ingredient of tax management. An assessee has to keep reliable, complete and updated documentation for all the relevant tax files so that the documentary evidence can be made available at a short notice whenever it is required. In absence thereof, an assessee may lose a case for want of proper documentary evidence. Not only that the company has to maintain proper account books, records, vouchers, bills, correspondence and agreements, etc. as a part of tax management. In the case of new industrial ndertaking
it is better to keep separate accounts for the same.

(c) Data Collection

The staff concerned with taxation has to collect and keep on collecting data relating to latest circulars, case laws, rules and provisions, and other government notifications to keep abreast of the current developments. This could also guide them in any particular area, when such guidance is needed. The composition of organisation of such data bank may vary from one organisation to another. However, keeping in view the general areas of operation of the company, it may, be advisable to arrange the data in the order of subject sequence. This would enable easy availability of information at the relevant time.

(d) Integration

Tax planner should be consulted by all the departments of the company to know the impact of taxation on their decisions. It would be necessary to integrate and properly link all the departments of the company with the tax planning department. Any project or blue print may have a tax angle. This has to be identified early enough to facilitate better tax compliance and availing of the several incentives. The department has to deal with all taxes (both State, Central and Local Self Governments).

(e) Constant Monitoring

In order to obtain the intended tax benefits, persons connected with tax management should ensure compliance of all the pre-requisites, like procedures, rules etc. Besides, there should be constant monitoring, so that all the tax obligations are discharged and penal consequences avoided.

(f) Developing Tax effective Alternatives

A managerial decision could be assumed to have been well taken only if all the pros and cons are considered. A tax planner could guide important decisions, by considering varieties of alternatives and choices.

(g) Take advantage of variance allowances and deductions

A tax manager has to keep track of the provisions relating to various allowances, deductions, exemptions, and rebates so as to initiate tax planning measures. The details of various tax incentives have been duly dealt with in the relevant studies in this book.

OVERALL TAX PLANNING MEASURES

Apart from location and nature of business, form of organisation is another important area where tax planning with reference to setting up a new business could be exercised. It is discussed that, company form of organisation is to be preferred from long-term point of view. There are, however, certain other dimensions in this context. One such dimension is the preference for a widely held company as against a closely held

company so much that we would suggest conversion of an existing closely held company into a widely held company because a widely held company would be able to enjoy the following tax benefits over a closely held company.

(a) Widely-held companies do not find limitations and restrictions in the matter of set off and carry forward of losses whereas closely-held companies have certain limitations or restrictions in this respect under the provisions of Section 79 of the Act. In the case of companies in which the public are not substantially interested, losses will not be carried forward and set off unless: the shares of the company carrying not, less than 51 per cent of the voting power were beneficially held by the same person(s) both on the last day of the previous year in which loss occurred and on the last day of the previous year in which brought forward loss is sought to be set off.

However, if a change in voting power as aforesaid takes place consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift, then the aforesaid disability does not get attracted. This disability is also not attracted where change in the shareholding of an Indian company which is a subsidiary of a foreign company, take place as a result of amalgamation or demerger of a foreign company subject to the condition that fifty one percent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company. The provisions of Section 79 of the Act are applicable in the case of carry forward and set-off of losses only. As carry forward of unabsorbed depreciation allowance, investment allowance, development rebates

and development allowance stands on an altogether different footing; their carry forward and set off is not governed by Section 79 of the Act in view of the decision of Madras High Court in CIT v. Concord Industries Ltd. (1979) 119 ITR 458 (Madras).

The Madras High Court's decision was later followed by the Kerala High Court in Commissioner of Income Tax v. Kalpaka Enterprises (P) Ltd. 986, 157 ITR 658 holding that Section 79 of the Income Tax Act, 1961 overrides the other provisions in Chapter VI and not the other provisions in the Act itself as is clear from the opening words 'Notwithstanding anything contained in this Chapter'. The connotation of the expression 'loss' occurring in Section 79 has thus to be understood in the context of the provisions contained in Chapter VI itself. The 'loss' mentioned in Section 79 is relatable to the 'loss' specifically provided for in the other provisions of the said Chapter. It is in respect of losses which could be carried forward and set off under the said Chapter that Section 79 operates to limit that set off only to the previous year in question without extending it to any prior years. The Act does not treat or describe 'unabsorbed depreciation' or 'unabsorbed development rebate' as losses and these items cannot be treated as losses for purposes of Section 79. Hence, the bar imposed under Section 79 does not apply to 'unabsorbed depreciation' or 'unabsorbed development rebate'.

In this case, while finalising the assessment for the year 1969-70, the Income-tax Officer, after adjusting the losses brought forward from the

preceding three years, determined the total income, as nil and also recorded inter alia, that unabsorbed depreciation for the prior years 1964-65 should be carried forward. The order of the income-tax Officer was set aside by the Commissioner in view of the fact that the officer had allowed set-off of the earlier year's losses against the profits of the year without considering the question of the applicability of Section 79 of the Act. The Tribunal, however, held that Section 79 of the Act did not apply to the unabsorbed depreciation and development rebate. On a reference to the High Court, the Court held that the Tribunal was right in holding that the provisions of Section 79 of the Act prohibiting the carry forward of losses in certain Companies would not apply to unabsorbed depreciation and development rebate.

(b) The provisions of 'deemed dividend' in respect of advances or loans to shareholders, or any payment on behalf of shareholders or any payment for the individual benefit of a shareholder are applicable to closely held companies under Section 2(22)(e) of the Act.

(c) The conversion would not be treated as transfer of ownership of the business and hence, there shall be no liability for capital-gains tax or Income tax in the hands of the closely-held company or the new widely-held company, due to conversion.

SOME GENERAL CONSIDERATIONS REGARDING NEW BUSINESS

1. Separate Accounts: It is advisable, though not a statutory obligation, to keep the accounts of the new business separate. This obviates the necessity of making any estimates, complicating the state of affairs of the new business. In this connection, reference may be made to CIT v. Dunlop Rubber Co. (I) Ltd., 1977 (107 ITR 182).

In this case, the existing company established a new factory and no separate accounts were maintained by the new unit. But, as a matter of fact, this was not essential for claiming the benefit. In this case the assessee claimed the benefit on the proportion of turnover between the new unit and old unit. Was the method adopted correct? The duty of Revenue Department was to determine the exemption allowed by law.

It was held : "it was the duty of the I.T.O. under Sections 143 to 145 of the Act, to determine the total income of the assessee and determine the tax payable, even if the income could not be derived from the books of the assessee. So, Income-tax Officer cannot deny the relief. Difficulty in computing the relief cannot be a ground for rejecting the claim. A rule of apportionment consistent with commercial accounting must be evolved in computing the income. If the assessee already followed certain system, which is in vogue in general, from a commercial accounting angle, and if the Income-tax Officer disputes such system he should correct it and cannot reject it as whole-sum. In this case it was held that the Income-tax Officer could not refuse the claim for exemption. Supreme Court in Textile Machinery Corporation Ltd. v. Commissioner of Income-tax (1977 108 ITR 195) interalia, held

that the fact that there was common management or the fact that separate accounts had not been maintained, would not lead to the conclusion that they were not separate undertakings. Even if separate account is not maintained, the investment in each of the units can be reasonably determined with the material which the assessee may make available to the department. The test is whether it is a new and identifiable undertaking separate and distinct from the existing business. It is sufficient if the new undertaking is an integrated unit by itself wherein articles are produced and a minimum of 10 persons are employed. In Mahindra Sintered Products Ltd. (1989, 177, ITR 111), the Bombay High Court held that it was not necessary that separate accounts had to be maintained but separate accounts kept in the ledger are sufficient to claim deduction under Section 80J. Following the ratio laid down by the Bombay High Court in the case of Mahindra Sintered Products Ltd. (supra) the Patna High Court held that the in order to claim special deduction under Section 80J, the following facts have to be established by the assessee namely:

(i) investment of substantial fresh capital in the new industrial undertaking set up,

(ii) employment of requisite labour therein,

(iii) manufacture or production of articles on the said undertaking,

(iv) earning of profits clearly attributable to the said undertaking, and

(v) above all, a separate and distinct identity of the industrial unit set up.

The fact that there was common management or the fact that the separate accounts had not been maintained or that there was a common source of power would not mean that it was not a new undertaking. The assessee was held entitled for relief under Section 80J.

Following its judgement in the case of Mahindra Sintered Products Ltd. (supra) the Bombay High Court held in Commissioner of Income-tax v. Mazaggon Dock Ltd. (1991, 191 ITR 461) that the maintenance of separate accounts is not a condition precedent for claiming special deduction under Section 80J. Since the frigate project was a new one and the capital outlay was many times more than the assessee’s capital, the assessee was entitled to deduction under Section 80J.

Though Section 80J is omitted with effect from 1.4.89, the ratio is applicable on other deduction available.

2. Avoid interconnection of service or departmental centralisation or pooling of resources of the new business and any other activity of the assessee. In this connection, a reference may be made to T. Satish U. Pai v. CIT 119 ITR 877 (Kar).

3. Avoid, transfer of goods between the new business and the assessee’s other activities and encourage only cash flows out of sale proceeds towards investment or capital purpose.

4. It is better for the new business to have separate floor area, separate licenses and agreements, if it is not related to the assessee at all. Even separate profit computation should be encouraged. But the total income should be computed as per the scheme of the Act. [CIT v. Kashmir Fruit and Chemical Industries, 1975 98 ITR 311 (J & K)].

5. In case of capital intensive industries having long gestation periods; generally profit earning would be delayed. This is true even in the case

of complicated and time-consuming manufacturing processes. In such circumstances, it is quite likely that only 'deficiency' would be absorbed.

6. Each industrial unit (for example, weaving and spinning units in case of textile business) of an industrial organisation has to be considered for computing the tax holiday benefit.

7. Any capital or revenue expenditure incurred towards scientific research under Section 35, will be treated as mentioned therein.

SETTING UP AND COMMENCEMENT OF BUSINESS VIS-A-VIS TAX PLANNING

Setting up a business within the scope of the Income Tax Act is a particular point to be considered for the purpose of tax planning strategy. It is different from the commencement of business. The company may be incurring certain expenditure of revenue nature during the intervening period after setting up and before the commencement of business (production). It is provided in the tax laws that the general expenses prior to the date of setting up are inadmissible but those incurred from the date of setting up and before the commencement of the business may be allowed as deduction for tax purposes provided they are of revenue nature and are incurred wholly and exclusively for the purpose of business.

From the decisions of the Bombay High Court in Western India Vegetable Products Ltd. v. CIT [(1954) 26 ITR 151 (Bom)] and the Supreme Court in CIT v. Ramaraju Surgical Cotton Mills Ltd. [(1967) 63 ITR 478 (SC)] and Travancore Cochin Chemical Pvt. Ltd. v. CIT [(1967) 65 ITR 651 (SC)], it has been well settled that a business is set up as soon as it is ready to commence production and it is not necessary that the actual production should be so commenced. It is also observed that the business commences with the start of first activity in point of time and which must necessarily precede other activity.

In the case of CIT v. Saurashtra Cement and Chemical Industries Ltd. [(1973) 91 ITR 170 (Guj.)], the decision of the Gujarat High Court is worth noting. In this case the company was established for manufacturing cement. The court observed that :

“the business is set up as soon as acquiring of lime stone is commenced even if at that time, the plant and machinery may not have been installed so that actual manufacturing operations may commence. They have expressed the view that the business commences with the start of activity which is first in point of time and which must necessarily precede other activities. The court observed that the business comprises several activities. Starting of one of those activities may in some circumstances fulfil the principal condition of setting up of a business. All the activities of the business need not be started simultaneously. But when an activity, which is the first in order of sequence preceding other activities is started, then it can be said that the company has been set up.”

In the case of Commissioner of Income-tax v. Saurashtra Cement and Chemical Industries Ltd. (1973, 91 ITR 170) the Gujarat High court had, inter alia, held that ‘Business’ connoted a continuous course of activities. All the activities which go to make up the business need not be started simultaneously in order that the business may

commence. The business would commence when the activity which is first in point of time and which must necessarily precede all other activities is started.

Reliance on the above case was placed by the Allahabad High Court in the case of Mod Industries Ltd. v. Commissioner of Income Tax (1977, 110 ITR 855) while deciding the question of allowance of business expenditure, it was held in this case that the foreign tour expenses of the chairman for setting up of two new factories were not - allowable as business expenditure under Section 37 and were of a capital nature. The ruling of the Gujarat High Court was applied by it in the case of Hotel Alankar v. Commissioner of Income Tax (1982, 133 ITR 866) holding that when a business is established and is ready to commence business, it can be said of that business that it has been set up. The words ‘ready to commence' would not necessarily mean that all the integrated activities are fully carried out and/or Wholly completed. This requirement is also complied with in a given case where an assessee had undertaken the first of the kind of integrated activities of which the business in overall comprised of, the question whether a business has been set-up or not is always a question of fact which has to be decided on the facts and in the circumstances of the case subject to the broad guidelines provided by different decisions in that behalf. With regard to setting up of business or commencement of business, there is another decision of the Gujarat High Court in the case of Sarabhai Management Corporation Ltd. v. Commissioner of Income Tax (1976), 102 ITR 25 where it has held that, it is only after the business is setup that the previous year of that business commences and any expenses incurred prior to the setting up of a business would be of capital nature and not a permissible deduction. There may, however, be an interval between the setting up of the business and the commencement of the business, all expenses incurred during that interval would be a permissible deduction. Applying this decision, the Punjab and Haryana High Court in the case of Commissioner of Income-tax v. O.P. Khanna and Sons (1983, 140 ITR 558) (the assessee carried on business of printing press, purchased a new building in November 1970, installed electrical fittings and shifted to the building in Sept. 1971) held that during transitory period the building had been ‘used’ by the assessee and the depreciation allowance had to be made in respect of it while computing its business income.

The Gujarat High Courts’ decision in the case of Sarabhai Management Corporation Ltd. (supra) had been affirmed by the Supreme Court in Commissioner of Income Tax v. Sarabhai Management Corporation Ltd. (1991, 192 ITR 151) holding that even if the acquisition of the property for being let out could be said to be only

the preparatory stage, the subsequent activities constituted activities in the course of the carrying on the assessee’s business. It was not correct to treat the assessee as having commenced business only when the licensee orlessee occupied the premises or started paying rent. The High Court was held to be right in interfering with thefinding of the Tribunal which was based on a mis-direction in law.The Andhra Pradesh High Court laid down the following principles to determine whether a business has commenced or not in Commissioner Income Tax v. Sponge Iron India

Ltd. (1993, 201 ITR 770): Whether a business has commenced or not is a question of fact.

(i) There is a distinction between the setting up of business and the commencement of business.

(ii) Where the business consists of a continuous course of activities, for commencement of business all the activities which go to make up the business need not be started simultaneously. As soon as an activity which has the essential activity in the course of carrying on the business is started, the business must be said to have commenced.

In this case it was held, on facts, that since the business had not commenced, the interest income could not be treated as business income. It was also held that the assessee was not entitled to the deduction of the administrative expenses and exploration and mining expenses from out of its interest income.

Income pending setting up of business : It is possible that pending setting up of business the funds raised by a company may be invested temporarily so that they do not remain idle. Income from such investments is taxable under income from other sources'. Expenses pending setting up of business like salary to staff, office expenses etc. cannot be deducted from such investment income [Traco Cable Co. Ltd. v. CIT (1969) 72 ITR 503 (Ker.)]. Companies in such a scenario are in an unenviable position. On the one hand they are incurring expenses whichgo a begging and on the other, they have income from investments which are taxed. The Madras High Court in CIT v. Seshasayee Paper & Boards Ltd. (1985) 156 ITR 542 (Mad.)] held that set off under Section 72 of the Act is also not possible because the expenses on business if they are not allowable as a deduction, cannot assume the form of loss either so as to qualify for set off against income from investments. Companies may therefore expedite setting up of business so that the business loss may be set off against such income from other sources. It may be noted that the view expounded by the Madras High Court in Seshasayee (supra) has been endorsed by the Supreme Court in Tuticornn Alkale Chemicals & Fertilisers Ltd. v. CIT (1997) 27 CLA 41. In a subsequent judgement CIT v. Bokare Steel Ltd. (1999) 33 CLA (Sur.) 18, however the Supreme Court has pointed out that where it is possible to establish a link between investment income pending commencement of business with the cost of project, the same can be reduced from the cost of assets it has in fact gone to subsidies.

REVIEW QUESTIONS

1. Explain the concept of tax planning and state its importance for a company.

2. (a) Explain the three methods by which an assessee can reduce his tax liability.

(b) Distinguish between tax evasion and tax avoidance?

3. Explain the two schools of thought on tax avoidance. Enumerate the general principles regarding tax
avoidance.

4. What are the objectives of tax planning? Enumerate the requisites for its success.

5. Discuss in detail the areas where the tax planning can be resorted to by an assessee.
6. Compare the different forms of organisation from tax liability points of view.
7. Explain the significance of judicial pronouncements, notifications and circulars in the context of tax
planning and outline the statutory force of notifications, circulars and rules framed by the Central Board for Direct Taxes.

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan
4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

IMPORTANT NOTES

UNIT-14 WEALTH TAX ACT, 1957

CONTENTS

- Charge of Tax
- Incidence of Wealth-tax
- Valuation Date [Section 2(q)]
- Tax Rate
- Net Wealth
- Return of Wealth
- Assessment
- Liability to Assessment in Special Cases
- Payment and Recovery of Wealth-Tax
- Refunds (Section 34A)
- Rectification of Mistakes (Section 35)
- Settlement of Cases
- Appeals, Revisions and References
- Penalties under the Wealth-Tax Act
- Offences and Prosecutions (Sections 35A to 35N)
- Review Questions
- Further Readings

Wealth tax shall be charged in respect of the net wealth on the corresponding valuation date of every individual, Hindu Undivided Family and company at the rate of one per cent of the amount by which the net wealth exceeds thirty lakh rupees.

INTRODUCTION

Wealth Tax in India is levied under Wealth Tax Act, 1957 on the net wealth of assessee and it extends to whole of India including the State of Jammu and Kashmir. The calculation of net wealth is to be done as per provisions of Wealth Tax Act, 1957. Wealth tax is a direct tax and is to be paid year after year on the same property on its market value, whether or not such property yields any income.

CHARGEABILITY

Chargeability to tax depends upon the nationality and residential status of the assessee same as the residential status for the purpose of the Income Tax Act. The Wealth Tax is charged for every assessment year in respect of
the net wealth of the corresponding valuation date of every individual, Hindu Undivided Family, and company, @1% of the amount by which net wealth exceeds ` 30 lakh. By virtue of section 45 of Wealth Tax Act, 1957, no
wealth tax is chargeable in respect of net wealth of the following persons:

1. any company registered under Section 25 of the Companies Act, 1956;
2. any cooperative society;,
3. any social club;
4. any political party within the meaning of explanation to Section 13Aofthe Income-tax Act; and

5. any mutual fund within the meaning of Section 10(23D) of the Income-tax Act.
6. the Reserve Bank of India incorporated under the Reserve Bank of India Act, 1934.

DEFINITIONS

(i) Individual

1. As per section 3, the term individual includes –
(a) a natural person or human being;
(b) Hindu Deity or mutawalli of a wakf as a juristic individual;
(c) group of individuals, being trustees of a trust [Trustees of Gordhandas Govind Ram Family Charity Trust v. C.I.T. (1973) 88 ITR 47 (S.C.)];
(d) holder of an impartible estate;
(e) group of individuals like Mappilla Tarwards. [W.T.O. v. C.K. Mammed Kayi (1981) 129 ITR 307
(S.C.)].
(f) AOP, where the shares of the members are indeterminate or unknown.

(ii) Hindu Undivided Family

The expression Hindu Undivided family (HUF) has not been defined in the act and the expression Hindu Undivided Family must be construed in the sense in which it is understood under the Hindu Law [Surjit Lal Chhabda v. CIT 101 ITR 776 (SC)]. For the purpose of levy of wealth tax Act, Jain and Sikhs families are also covered under the term HUF [CWT v. Champa Kumari Singhi (1972) 83 ITR 720 (SC)].

(iii) Company

The term 'company' is defined in Section 2(h) of the Wealth-tax Act, 1957. According to this section the term 'company' means the same as is defined in Section 2(17) of the Income-tax Act, 1961 which is given hereunder:
Company means:
(i) any Indian company, or
(ii) anybody 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.

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 Who is a resident but not ordinary resident in India or Non resident in India All assets and debts located in and out • All assets in India except the assets represented by any of India are to be taken in computation loans and debts-owing to the assessee interest whereon is of net wealth of the assessee except exempt from income-tax under Section 10 of the Income exempted assets and including tax Act. deemed assets are chargeable. • 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. In the case of a HUF a Company Resident in India Non Resident ot Not ordinary resident in India All assets and debts located in and • All assets in India except the assets represented by any out of India are to be taken in loans and debts-owing to the assessee interest whereon is computation of net wealth of the exempt from income-tax under Section 10 of the Incomeassessee except exempted assets tax Act.

and including deemed assets • All debts in India except, the debts secured on any are chargeable. 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.

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)].

TAX RATES

With effect from the assessment year 2010-11 onwards, as per the amended Section 3, wealth-tax shall be charged in respect of the net wealth on the corresponding valuation date of every individual, Hindu Undivided Family and company at the rate of one per cent of the amount by which the net wealth exceeds thirty lakh rupees.

NET WEALTH [section 2(m)]

The concept of 'net-wealth' is very important for wealth-tax purposes because net wealth is the tax base. According to Section 2(m) "net-wealth" means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets.

Computation of Net-Wealth

Net wealth shall be computed in the following manner:

Value of Assets u/s 2(ea) belong to the assessee as on valuation date XXX

Add: Deemed assets under section 4 XXX

Less: Assets exempt u/s 5 XXX

Gross wealth XXX

Less: Debts incurred in relation to the assets included in the net wealth XXX

Net Wealth XXX

While computing "net-wealth", the following assets are not includible in the net-wealth of an assessee:

(i) Assets exempt under Section 5(1).

(ii) Under Section 6, in case of an individual who is not a citizen of India or who is citizen of India but a nonresident 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 chargebale to wealthtax, 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.

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 stockin- trade);
(iii) Jewellery
(iv) Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);
(v) Urban land;
(vi) Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.

(i) House:

1. The house means any building or land appurtenant thereto used for-
– residential or commercial purposes
– maintaining a guest house or
– a farm house.
2. The house must be situated within twenty-five kilometers from local limits of any municipality/ Municipality Corporation or by any other name or a Cantonment Board.
3. The house will not include-
• a house meant exclusively for residential purposes and which is allotted by a company to an
employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than ten lakh rupees;
• any house for residential or commercial purposes which forms part of stock-in-trade;
• any house which the assessee may occupy for the purposes of any business or profession carried on by him;
• any residential property that has been let-out for a minimum period of three hundred (300) days in the previous year;
• any property in the nature of commercial establishments or complexes;

(ii) Motor Car

All motor cars whether Indian or Foreign (other than those used by the assessee in the business of running them on hire or as stock-in-trade);

(iii) Jewellery

(1) Jewellery includes any jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other

precious metal or any alloy containing one or more of such precious metals (other than those held by the assessee as stock-in-trade);
(2) It also includes - (i) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones, and whether or not worked or sewn into any wearing apparel; (ii) precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel;
(3) And does not include: The Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

(iv) Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);

(v) Urban land

1. The urban land means land situated in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board And which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the valuation date or not being 2 km from the local limits of any municipality and which has a population of more than 10,000 and upto 1 lakh or not more than 6 km, from the local limits of any muncipality having more than 1 lakh or upto 10 lakh or not being more than 8 km, from the local limits of any muncipality having population of more than 10 lakh
2. The urban land means any area located within eight kilometers from the local limits of any municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board but does not include:
– But does not include land classified as agricultural land in the records of the government and used for agricultural purposes or land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or – the land occupied by any building which has been constructed with the approval of the appropriate authority or – any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him or – any land held by the assessee as stock-in-trade for a period of five years from the date of its acquisition by him.

(vi) Cash in hand

Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu Undivided families and in the case of other persons any amount not recorded in the books of account.

ASSETS BELONGING TO OTHERS BUT INCLUDIBLE IN THE NET-WEALTH OF AN INDIVIDUAL (DEEMED ASSETS) SECTION 4

(a) The individual must be the owner of these assets.
(b) These assets must be transferred without adequate consideration.
(c) These assets must be held by the transferee on the valuation date. If the asset has been spent, lost or destroyed before the valuation date, the

value of such asset shall not be included in the net-wealth of the individual. If the form of assets transferred is changed before the valuation date, the substituted assets shall be included in the net-wealth of the individual. If the substituted asset is one which is exempt from wealth-tax, it shall not be included in the net-wealth of the transferor. Further, if any debt is incurred on the transferred assets by the transferee, and which is payable on the valuation date, it shall be deducted from the value of the transferred assets.

According to Section 4, the following transfers shall be included in the net-wealth of an assessee:

(1) Assets transferred to spouse [Section 4(1)(a)(i)]

Assets transferred by an individual to his or her spouse directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart. In this connection the following points are important:

(a) The asset must be transferred to spouse, i.e., a person who is lawfully wedded and the relationship of spouse must exist on the two dates namely, the date of transfer and the valuation date.

Thus, if the transferor and the transferee were not in the relation of husband and wife on the date of the transfer, but they had merely entered into an agreement to marry, a mere alliance, such a transaction would not attract this clause. Again a divorce terminates the legal relationship between spouses and, therefore, the transfer between the divorced husband and wife would not be affected by the present sub-clause. The existence of relationship is necessary not only on the date of transfer but also on the valuation date. Thus, if transfer is effected before the marriage is solemnised, or, although the transfer is effected during subsistence of marriage, but on the valuation date such relationship is terminated, then in both the cases, the value of assets cannot be included in the net-wealth of the transferor.

(b) The asset may be transferred directly or indirectly by an individual to the spouse. A direct transfer may be by 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, therefof, Y transfers his property to his mother, it would really be a case of both X and Y adopting circuitous method to evade tax. In such a case, the veil would be pierced through to expose the real character of the so-called independent transactions and both X and Y would be subject to the operation of this clause [CIT v. C.M. Kothari (1963) 49 ITR 107 SC].

(c) The asset must be transferred without adequate consideration. Love and affection may be a good consideration but it is not adequate consideration. 'Adequate consideration'; means something more than valid consideration. It must be construed as valuable consideration capable of being compared and measured with money or money's worth. If the property has been transferred without adequate consideration, the difference between the adequate consideration and inadequate consideration shall be included in the net-wealth of transferor.

(d) If the asset has been transferred under an agreement that husband and wife shall live apart and the
agreement is genuine and not sham, the value of the asset transferred shall not be included in the netwealth
of the transferor. The phrase "to live separately" is of wider connotation and even the voluntary
agreements to live apart fall within it.

The arranagement 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)]

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.

(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.

(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.

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.)].

(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 Jwellery 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)]

Notes

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 Nonresident (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.).

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).

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 netwealth.

(ii) Payment of tax may be held in abeyance where the assets taken into account for assessment are located outside India in cases where the laws of that country prohibit or restrict the remittance of money to India.

(iii) Tax rebate is granted to an individual and a H.U.F. in respect of their assets located outside India. Though the question as to where an assets is located is essentially one of fact and will have to be determined in the light of evidence, guidelines, as follows, may be used for the purpose:

(a) Tangible Immovable Property: The location of the tangible immovable property (land, buildings, lakes, etc.) is in India, if it is physically situated in India.

(b) Intangible Immovable Property: Rights or interest in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India if the immovable property to which the rights are attached or out of which the benefits arise, lies in India.

(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.

(e) Ship or Air Crafts: They are located in India if they are registered in India.

For assets which are covered by the above items, the location shall be determined having regard to the nature of the assets.

VALUATION OF ASSETS

Wealth-tax is charged on the net-wealth of the assessee, therefore, it is an important function of the Assessing Officer to determine the value of the assets held by the assessee on the valuation date. Section 7 lays down the method of its determination, the value of any asset, other than cash, shall be the value thereof determined in the manner laid down in Schedule III.

(A) VALUATION OF IMMOVABLE PROPERTY

The valuation of immovable property is given in Part B of Schedule III of the Wealth tax Act.

Steps for Valuation of immovable property:

1. Determine annual rent.
2. Calculate Gross maintainable rent.
3. Calculate Net Maintainable Rent.
4. Capitalise Net Maintainable Rent as per the given formula in Rule 3.
5. Now make adjustments for unbuilt area of plot of land

6. Then adjust for unearned increase in the value of the land.
7. At last compare the value derived with actual cost of construction as given below in (g) to determine the value to be taken for wealth tax purpose.

(a) Determination of Annual Rent:

Annual Rent is equal to: Actual rent received or receivable (including all payments /benefits/perquisites paid by the tenant for the use of the property in any form or name) (if property is let out throughout the year ending on the valuation date)

Or

Actual rent received or receivable (including all payments /benefits/perquisites paid by the tenant for the use of the property in any form or name) × 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 IS NOT LET OUT

GMR= Higher of following two: GMR= Annual rent assessed by the local authority

• Annual rent received or receivable for the purposes of levy of property tax or any other

• Annual value assessed by the local tax. authority for the purposes of levy of OR property tax or any other tax 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= And the unexpired period of the
Net maintainable rent > (12.5) lease < Fifty years

Value of any immovable property= Value of any immovable property=
Net maintainable rent × (10) 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:

(f) Adjustment for unearned increase in the value of the land (Rule 7):
It is applicable when:
(a) The property is constructed on land obtained on lease from
– the Government,
– a local authority or
– any authority referred to in clause (20A) of section 10 of the Income-tax Act,
and
(b) The Government or any such authority is entitled to claim and recover a specified part of the unearned increase in the value of the land at the time of the transfer of the property, under the terms of the lease.
The value of such property
Value of property as determined under Rule 3 after making adjustment for unbuilt area of plot if any XXX
Less: Lower of the following two
– Amount equal to 50% of the value of the property as determined above
– Amount liable to be claimed and recovered by the Government for unearned increase. XXX
where, unearned increase= (value of such land on the valuation date as determined by the Government or authority - amount of the premium paid or payable to the Government or such authority for the lease of the land)

(g) Now compare the value derived with actual cost of acquisition,
If the property is acquired or construction of property is completed after the 31/03/1974. The value of such property will be higher of following:
– Value derived above after all the adjustments.
– Actual cost of acquisition/construction and cost of improvement.
This clause will not be applicable for:
– Only one residential house exclusively used for his own residential purposes throughout the period of
12 months immediately preceding the valuation date and
– If the actual cost of acquisition/construction plus cost of improvement, does not exceed, –
If the house is situated at Mumbai, If the house is situated at any other place.
Kolkata, Delhi or Chennai.

(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.

(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 alued 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.

(D) VALUATION OF LIFE INTEREST

According to the Rule 17(1) (Part F of Schedule III), the value of the life interest of an assessee is–

[(Average annual income accrued to the assessee from the life interest) * {1/(p+d)-1}].

Where,

p= the annual premium for a whole life insurance without profits on the life of the life tenant for unit sum assured as specified in the Appendix to these rules

d = i / (1+i), i is the rate of interest.

i = 6½ % per annum

Average annual income= (Average gross annual income) – (Average Expenses incurred on collection of such income)

Average annual gross income = (Total gross income from the life interest) / (Total number of years)Average Expenses = (Total expenses incurred on the collection of such income) / (Total number of years)

Note:

– Average expenses incurred on collection of such income shall not exceed 5% of the average annual gross income.

– Average annual income will be calculated only for the period of maximum 3 years preceding the period ending on the valuation date

– The Assessing Officer may vary the normal premium rates in force and determine value accordingly if he thinks that the normal rates are low or any insurance company would not provide insurance at that premium.
– The value of the life interest determined above shall not be greater than the value of the corpus of the trust determined under schedule III of this Act.

Notes

(E) VALUATION OF JEWELLERY (PART G OF SCHEDULE III)

The value of the jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date i.e. the fair market value. The return of net wealth furnished by the assessee shall be supported by,–
– a statement in the prescribed form (if the value of jewellery = 500,000)
– a report of a registered valuer in the prescribed form (if the value of jewellery > 500,000)

The Assessing Officer (AO) may refer the valuation of jewellery to a Valuation Officer under Section 16A(1) and the value of such jewellery shall be the value as estimated by the Valuation Officer, if AO is of the opinion that: The value of the jewellery declared in the return < fair market value by such percentage as is prescribed under Section 16A(1)(b)(i) of the Act;

The value of the jewellery declared in the return < fair market value.

The value of jewellery so estimated by the Valuation Officer shall be taken to be the value of such jewellery for the subsequent 4 (four) assessment years, subject to the following adjustments:–
– where the jewellery includes gold or silver or any alloy containing gold or silver, the value of such gold or silver or such alloy as on the valuation date relevant to the concerned subsequent assessment year shall be substituted for the value of such gold or silver or alloy on the valuation date relevant to the first assessment year;
– where any jewellery or part of jewellery is sold or otherwise disposed of by the assessee, or any jewellery or part of jewellery is acquired by him, on or before the valuation date relevant to the concerned subsequent year, the value of the jewellery determined for the first assessment year shall be reduced or increased, as the case may be, and the value as so reduced or increased shall be the value of the jewellery for such subsequent assessment year.

(F) VALUATION OF ASSETS IN OTHER CASES (PART H OF SCHEDULE III)

The value of any asset, other than cash, not covered by above schedules shall be the fair market value as in the opinion of the Assessing Officer on the valuation date. If the valuation of any asset is referred by the Assessing Officer to the Valuation Officer under section 16A, the value of such asset, shall be the fair market value as in the opinion of the valuation officer on the valuation date. If the value of any asset cannot be estimated under this rule because it is not saleable in the open market, the value shall be determined in accordance with such guidelines or principles as may be specified by the Board from time to time by general or special order.

The price or other consideration for which any property m ay be acquired by or transferred to any person under the terms of a deed of trust or

through or under any restrictive covenant in any instrument of transfer shall be ignored for the purposes of determining value under any provision of this Schedule and the price of such property would be the price the property would fetch if sold in the open market on the valuation date. **ROUNDING OFF OF NET-WEALTH (SECTION 44C)**

Under Section 44C, the net-wealth computed under the provisions of the Act shall be rounded off to the nearest
multiple of ` 100. If the amount contains a part of one hundred rupees and if such part is fifty rupees or more, the
amount shall be increased to the next higher amount which is multiple of hundred. If such part is less than fifty
rupees, the amount shall be reduced to the next lower amount which is a multiple of one hundred. The amount
so rounded off shall be deemed to be the net-wealth of the assessee.

ROUNDING OFF OF TAX, INTEREST, PENALTY ETC. (SECTION 44D)

The amount of wealth-tax, interest, penalty, fine or any other sum payable or refundable under the Act shall be rounded off to the nearest rupee. If the amount contains a part of rupee, then, if such part is fifty paise or more, it shall be increased to one rupee and if such part is less than fifty paisa it shall be ignored.

RETURN OF WEALTH

(1) Voluntary Return

The procedure under the Wealth-tax Act for making the assessment of net wealth begins with the filing of a return of wealth. Section 14 of the Act contains the relevant provisions relating to the filing of return of Wealth. According to that section it is statutorily obligatory for every person, if his net wealth or the net wealth of any other person in respect of which he is assessable under this Act on the valuation date exceeded the maximum amount which is not chargeable to wealth-tax, shall, on or before the due date, furnish a return of his net wealth or the net wealth of such other person as on that valuation date in the prescribed form and verified in the prescribed manner setting forth particulars of such net wealth and such other particulars as may be prescribed. Explanation: Sub-section(1) specifies the "due date" in relation to an assessee under the Wealth-tax Act, to be the same date as that applicable to an assessee under the Income-tax Act under the Explanation to Sub-section (1) of Section 139 of the Income-tax Act, i.e.,

(a) Where the assessee is a company, the 30th day of September of the assessment year;

(b) Where the assessee is a person, other than a company:

(i) in a case where the accounts of the assessee are required under the Income Tax Act or any other law to be audited or in the case of a partner of a firm where the accounts of the firm are required to be so audited, or, in the case of a co-operative society, the 30th day of September of the assessment year;

(ii) in a case where the total income referred to in Sub-section (1) of Section 139 includes any income from business or profession, not being a case falling under Sub-clause (i) hereinabove, the 31st day of July of the assessment year;

(iii) in any other case, the 31st day of July of the assessment year.
However, notwithstanding anything contained in any other provisions of the Wealth-tax Act, a return of net wealth which shows the net wealth below the maximum amount which is not chargeable to tax shall be deemed to have never been furnished.
It is further provided that Sub-section (2) shall not apply to a return furnished in response to a notice under Section 17;

(2) Return after Due Date and Amendment of Return (Section 15)

If any person has not furnished a return within the time allowed under Section 14(1) or under a notice issued under Section 16(4)(i), or having furnished a return discovers any omission or a wrong statement therein, he may furnish a belated return or revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier.
An assessment is made or completed when the order of assessment is signed by the Assessing Officer, and not when the assessment order or notice of demand is served on the assessee. If the assessee files the belated return or revised return before the assessment is made, the Assessing Officer is bound to consider such return and he cannot assess the assessee under Section 17 (wealth escaping assessment).

Return by whom to be signed (Section 15A)

The return of wealth must be signed and verified:
(a) In case of an individual:
(i) by individual himself;
(ii) where the individual is absent from India, by the individual concerned or by a person duly authorised by him;
(iii) where the individual is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf;
(iv) where for any other reason it is impossible for the individual to sign the return, by any person competent to act on his behalf.
(b) In case of Hindu undivided family:
(i) by the Karta;
(ii) where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of the family; and
(c) In the case of a company:
(i) by the Managing Director of the company;
(ii) where the Managing Director, because of any unavoidable reason could not sign the return, or where there is no Managing Director, by any Director thereof.
(iii) where the company is being wound up, whether under the orders of the Court or otherwise, or where any person has been appointed as the receiver of any assets of the company, the return has to be signed and verified by the liquidator referred to in Section 178(1).
(iv) where the management of the company has been taken over by the Central Government or any State Government under any law, the return has to be signed and verified by the principal officer thereof.
(v) where the company is not resident in India the return may be signed and verified by any person who holds a valid power of attorney from such company to do so, which shall be attached to the return.

POWER OF BOARD TO DISPENSE WITH REFURNISHING DOCUMENTS ETC. WITH RETURN OF WEALTH (SECTION 14A)

For a particular class or classes of persons the Board has a power to exempt such person or classes of person from the requirement of furnishing documents, statements, receipts, certificates, audit report, reports of register valuer or any other document which are required to be furnished along with return of net wealth. But, such documents are required whenever the demand is made by the Assessing Officer.

FILING OF RETURN IN ELECTRONIC FORM (SECTION 14B)

The Board has power to make rules for a particular class or classes of persons who shall be required to furnish the return in electronic form in such a form and manner as may be prescribed by Board. The Board also has a power to make rules providing for documents, statements, receipts, certificates, audit report, reports of register valuer or any other document which may not to furnished along with return of net wealth. But, such documents are required whenever the demand is made by the Assessing Officer. It may prescribed ten ways of making electronic records.

ASSESSMENT

(1) Self Assessment [Section 15B]

Where any tax is payable on basis of any return furnished under Section 14 or Section 15 or in response to a notice under clause (i) of Sub-section 4 of Section 16 or under Section 17, after taking into account the amount of tax, if any, already paid under any provision of this Act, the assessee shall be liable to pay such tax, together with interest payable under any provision of this Act for any delay in furnishing the return, before furnishing the
return and the return shall be accompanied by proof of payment of such tax and interest. Where the amount paid by the the assessee under Sub-section (1) (as above), falls short of the aggregate of the tax and interest as aforesaid, the amount so paid shall first be adjusted towards the interest payable as aforesaid and the balance, if any, shall be adjusted towards the tax payable.

After the regular assessment under Section 16 has been made, any amount paid under Sub-section (1) shall be deemed to have been paid towards such regular assessment.

If any assessee fails to pay the whole or any part of such tax or interest or both in accordance with the provisions of Sub-section (1), he shall, without prejudice to any other consequences which he may incur, be deemed to be an 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 assessee specifying the sum so payable, and such

intimation shall be deemed to be a notice issued under Section 30 and all the provisions of the Act shall apply accordingly; and

(ii) if any refund is due on the basis of such return, it shall be granted to the assessee and an intimation to this effect shall be sent to the assessee.

Provided that except as otherwise provided in this sub-section the acknowledgement of the return shall be deemed to be intimation under this sub-section where either no sum is payable by the assessee or no refund is due to him.

An intimation for any tax or interest due under this clause shall not, however, be sent after the expiry of two years from the end of assessment year in which the net wealth was first assessable.

(2) In the above cases, if the Assessing Officer considers it necessary or expedient to ensure that the assessee has not understated the net wealth or has not underpaid the tax in any manner, he shall serve on the assessee a notice requiring him, on a date to be specified therein, either to attend at the office of the Assessing Officer or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return:

Provided that no notice under the sub-section shall be served on the assessee after the expiry of twelve months from the end of the month in which the return is furnished.

(3) On the day specified in the notice issued under Sub-section (2) or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by order in writing, assess the net wealth of the assessee and determine the sum payable by him on the basis of such assessment.

(4) For the purposes of making an assessment under the Act, the Assessing Officer may serve, on any person who has made a return under Section 14 or Section 15 or in whose case the time allowed under Sub-section (1) of Section 14 for furnishing the return has expired, a notice requiring him on a date to be specified therein, -

(i) where such person has not made a return within the due date, to furnish a return of his net wealth or the net wealth of any other person in respect of which he is assessable under this Act, on the valuation date, in the prescribed form and verified in the prescribed manner, setting forth the particulars of such net wealth and such other particulars as may be prescribed, or

(ii) to produce or cause to be produced such accounts, records or other documents as the Assessing Officer may require.

(5) If any person, –

(a) fails to make the return required under Sub-section (1) of Section 14 and has not made a return or a revised return under Section 15, or

(b) fails to comply with all the terms of a notice issued under Sub-section (2) or Sub-section (4). the Assessing Officer shall, after taking into account all relevant material which he has gathered, and after giving such person an opportunity of being heard, estimate the net wealth to the best of his judgement and determine the sum payable by the person on the basis of such assessment: Provided that such opportunity shall be given

by the Assessing Officer by serving a notice calling upon the person to show cause, on a date and time to specified in the notice, why the assessment should not be completed to the best of his judgement:

Provided further that it shall not be necessary to give such opportunity in a case where a notice under Sub-section (4) has been issued prior to the making of the assessment under the sub-section. Where a regular or best judgement assessment is made, any tax or interest paid by the assessee shall be deemed to have been paid towards such regular assessment and, if no refund is due on regular assessment and the amount refunded exceeds the amount refundable on regular assessment, the whole of the excess refunded shall be deemed to be tax payable by the essessee.

(3) Reference to Valuation Officer (Section 16A)

Where for making a Wealth-tax assessment under the Act and Section 7 thereof, read with the relevant rules (in Wealth-tax Rules as well as Schedule III), the market value of any asset is to be taken into account in such assessment, the Assessing Officer may refer the valuation of any asset to the Valuation Officer under the following circumstances.

(i) where the value of the asset has been estimated by a registered valuer and the Assessing Officer is of the opinion that the value estimated by the registered valuer is less than its fair market value and it requires an upward revision;

(ii) in any other case, if the Assessing Officer is of the opinion that fair market value of the asset exceeds the value of the asset as returned by more than 33-1/3% or by more than ` 50,000; or (iii) if he considers it necessry to do so on account of the nature of the asset and other relevant circumstances. On a reference having been made to the valuation officer, he will proceed to value each asset separately after giving notice to the assessee to produce or cause to be produced before him, such accounts, records or other documents as he may require.

Where the Valuation Officer is of the opinion that the value of the asset has been correctly declared in the return made by the assessee, he shall pass an order in writing and send a copy of it to the Assessing Officer and to the assessee. Where the Valuation Officer is of the opinion that the value of the asset is higher than the value declared by the assessee, or where the asset is not disclosed, or the value of the asset is not declared in the return, or, where no such return has been made, he shall serve a notice on the assessee intimating the value which he proposes to estimate and give him an opportunity to state the objections, if any, on the date specified by the Valuation Officer. The assessee, either in person or through any other person, or in writing, can file his objections or produce or cause to be produced such evidence as he wants to rely on in support of his objections. After hearing all the evidence which the assessee may produce and considering all the material which the

Valuation Officer has gathered, he shall estimate the value of the asset and send a copy of his order to the Assessing Officer and the assessee. The order of the Valuation Officer is binding on the Assessing Officer who, after receiving the order, shall proceed to complete the assessment in conformity with the estimate of the Valuation Officer. Where the Valuation Officer values an asset for an amount less than the amount returned by the assessee,the value assessed by Assessing Officer would

be final. Further, the assessee can file an appeal against valuation report and valuation officer is bound to follow valuation rules given under Schedule III.

(4) Wealth Escaping Assessment (Section 17)

If the Assessing Officer has reason to believe that the net wealth chargeable to tax in respect of which any person is assessable under the Wealth-tax Act, has escaped assessment for any assessment year (whether by reason of under assessment or assessment at too low a rate or otherwise), he may, subject to the other provisions of this Section and Section 17A, serve on such person a notice requiring him to furnish within such period, as may be specified in the notice, a return in the prescribed form and verified in the prescribed manner setting forth the net wealth in respect of which such person is assessable as on the valuation date mentioned in the notice, along with such other particulars as may be required by the notice, and may proceed to assess or reassess such net wealth and also any other net wealth chargeable to tax in respect of which such person is assessable, which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section for the assessment year concerned and the provisions of the Wealthtax Act shall, so far as may be, be applicable as if the return were a return required to be furnished under Section 14.

It is further provided that in cases where assessment under Section 16(3) or this section has been made for the relevant assessment year, no action shall be taken under this section after expiry of four years from the end of the relevant assessment year unless any net wealth chargeable to tax has escaped assessment for such assessment year by reason of failure on the assessee's part to: (i) make a return under Section 14 or 15 or in response to a notice issued under

Section 16(4) or this section or, (ii) full and true disclosure of all material facts necessary for his assessment for that assessment year. And, the Assessing Officer shall, before issuing any notice under this sub-section, record his reasons for doing so.

Explanation to the proviso (as above) clarifies that production of account books and other evidence, before the Assessing Officer, from which material evidence could have been discovered by the Assessing Officer with due diligence will not necessarily amount to disclosure.

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, theAssessing 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 entioned in the notice. However, if the Assessing Officer has reason to believe that if the period of full 30 days s allowed to the assessee, it will be detrimental to the revenue, he may, with the previous approval of the Joint ommissioner, reduce period for the payment of the sum demanded.

Section 29A also provides that the Wealth-tax, as assessed, is payable though a reference has been made to the High Court or the Supreme Court. The provision implies that mere pendency of reference will not amount to a stay for recovery of demand.

If the demanded amount is not paid within 30 days or such lesser period, as may be prescribed by the Assessing Officer, the assessee shall be liable to pay simple interest @1% for every month or part of month for the period of default, i.e., the next day of the last date for payment, to the actual date of payment. According to Rule 12 the period and the amount in respect of which the interest is to be calculated shall be rounded off.

The rules regarding rounding off are as under:

(i) where interest is to be calculated on annual basis, the period for which such interest is to be calculated shall be rounded off to a whole month or months and for this purpose any fraction of a month shall be ignored; and the period so rounded off shall be deemed to be the period in respect of which the interest is to be calculated;

(ii) where the interest is to be calculated for every month or part of a month comprised in a period, any fraction of a month shall be deemed to be a full month and the interest shall be so calculated;

(iii) the amount in respect of which the interest is to be calculated shall be rounded off to the nearest multiple of one hundred rupees and for this purpose any fraction of one hundred rupees shall be ignored; and the amount so rounded off shall be deemed to be the amount in respect of which the interest is to be calculated.

Where, as a result of an order under appeal the amount on which interest was payable had been reduced, the interest shall be reduced accordingly and the excess interest paid, if any, shall be refunded. And, in respect of any period commencing on or after 7.9.2003, the interest for the period falling after that date shall be calculated @1% for every month or part of the month.

On an application made by the assessee before the expiry of the due date for payment, the Assessing Officer may extend the time for payment or allow the payment by instalments subject to such conditions as he may think fit to impose. If the assessee fails to pay the amount within the time allowed, he shall be deemed to be in default. Further in case of payment by instalments where the assessee commits any default in paying any one of the instalments within the time fixed, the assessee shall be deemed to be in default as to the whole amount due on that date and the other instalment or instalments shall be deemed to have been due on the same date as the

instalment actually in default. Where an assessee has presented an appeal to the commissioner (Appeals), the Assessing Officer may treat the assessee as not being in default in respect of the amount in dispute in the appeal so long as the appeal remains undisposed of. The assessee shall not be deemed to be in default where he has been assessed in respect of assets located in a country outside India, the laws of which prohibit or restrict the remittance of money to India. He shall not be deemed to be in default in respect of that part of the tax only which is attributable to the assets in that country and until the prohibition or restriction of remittance is removed. But, as soon as restriction on remittance is removed, the assessee must make the payment within the specified time, failing which he would be treated as assessee in default.

Mode of Recovery (Section 32)

The provisions relating to the mode of recovery of Income tax apply also to the recovery of Wealth-tax.

(2) Liability of Transferees of Properties (Section 33)

If an individual transfers assets to any of the persons mentioned in Section 4 (i.e., to spouse to a person or association of persons for the benefit of his or her spouse etc.) the transferred assets are included in the net wealth of transferor and he would be assessed to tax in respect thereof. Normally, as a general rule a transferee of property is not liable to pay tax due by the transferor in respect of a transferred asset but Section 33 provides that after issuing a notice of demand, the portion of the tax attributable to the transferred asset (on a pro rata basis) may be recovered from the transferee. If the transferred asset is held jointly by more than one persons, they shall be jointly and severally liable to pay the tax. If the transferee fails to pay the tax demanded from him, he shall be deemed in default and all the provisions relating to recovery shall apply accordingly.

REFUNDS (SECTION 34A)

Where a refund of any amount becomes due to the assessee, as a result of an appeal or other proceedings (reference, rectification of mistake or revision) the Assessing Officer shall refund the amount to the assessee without his having to make any claim in that behalf. However, where, by the order aforesaid, an assessment is set aside or cancelled and an order of fresh assessment is directed to be made, the refund, if any shall become due only on the making of such fresh assessment. And, if the assessment is annulled, the refund shall become due only of the amount, if any, of the tax paid in excess of the tax chargeable on the net wealth returned by the assessee.

Further, where refund of any amount becomes due to the assessee as a result of an order of assessment, whether pursuant to the filing of a return of wealth within or after due date/amendment or in response to a notice etc. and the Assessing Officer is of the opinion that in view of the matter being the subject-matter of an appeal or further proceeding or any other proceeding being pending, the grant of refund is likely to adversely affect the revenue, he may, with the previous approval of the Chief Commissioner or Commissioner, withhold the refund till such time as determined by the Chief Commissioner or Commissioner. Where a refund is found due to any person, the Assessing Officer, the Deputy

Commissioner (Appeals), or Commissioner (Appeals) or Chief Commissioner, or Commissioner after giving a written intimation to the assessee, may, in lieu of payment, set off the amount of refund against the amount, if any, remaining payable under this Act by the assessee.

With effect from 7.9.2003, as per Sub-section (4B), where any refund becomes due to the assessee under the Wealth-tax Act, he is entitled to receive simple interest thereon @ 1/2 per cent for every month or part of a month from the date/s of payment of the tax or penalty to the date of grant of refund. In the case of delay in the proceedings, attributable to the assessee, the period of delay shall be excluded from the period for which he is entitled to the interest. Further, in the case of reduction or increase in the amount on which interest is payable, as a result of an order of assessment or the orders by Appellate authorities in appeal, revision, or order of the Wealth-tax Settlement Commission, the interest shall also be correspondingly increased or reduced. In the case where the interest is reduced, the Assessing Officer shall issue a notice of demand to the assessee, calling for payment of the excess interest paid.

RECTIFICATION OF MISTAKES (SECTION 35)

With a view to rectify any mistake apparent from the record, the Assessing Officer, a Wealth-tax authority, the Valuation Officer, the Joint Director, Joint Commissioner, Director, Commissioner, Commissioner (Appeals), Appellate Tribunal may amend their respective orders either on his/its own motion or when it is brought to notice either by the assessee or where the authority concerned is the Valuation Officer or the Commissioner (Appeals) or the Appellate Tribunal, by the Assessing Officer.

If the amendment enhances the assessment or reduces a refund, the authority concerned cannot do so without giving a notice to the assessee of its intention to do so and allowing him a reasonable opportunity of being heard. If the assessee pays any amount of tax, penalty or interest in dispute within 6 months from the date of order passed in the first appeal or revision, the sum so paid would be allowed as a permissible deduction. This deduction would be allowed as a deemed rectification of mistake.

The order of amendment shall be passed in writing by the authority concerned and where it has the effect of enhancing the assessment or reducing a refund already made, the Assessing Officer shall serve on the assessee a notice of demand specifying the sum payable.

The time limit for rectification is four years from the end of the financial year in which the order was passed in the first appeal or revision and in other cases it is four years from the end of the financial year in which the order sought to be amended was passed.

SETTLEMENT OF CASES

The provisions regarding settlement of cases under this Act are the same as those of the Income-tax Act. Therefore, the students are advised to study these provisions from the Unit 12.

APPEAL TO COMMISSIONER (APPEALS) [SECTION 23(1A) & (B)]

Any person who is not satisfied by any of the following orders may file an appeal to the Commissioner (Appeals), in the prescribed form and verified in the prescribed manner:

(1) objecting to the amount of the Net wealth/amount of Wealth-tax determined to be payable or denying his liability to be assessed under this Act. The above is subject to the condition that the total wealth determined in assessment made under Section 16 exceeds ` 15 lakhs;

(2) objecting to the penalty imposed under Section 18(1), with the previous approval of the Deputy Commissioner, under Section 18(3); or

(3) objecting to any assessment or order referred to in the preceding items (i) to (viii), where such assessment or order has been made by the Deputy Commissioner in exercise of the powers or functions conferred on or assigned to him under Section 8 or 11; or

(4) objecting to any penalty imposed by the Joint Director or Joint Commissioner under Section 18A; or (5) objecting to an order made by an Assessing Officer in case of such persons or classes of persons as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations, direct. Sub-Section (1B), further provides that notwithstanding anything contained in Sub-section (1), the Board or the Director General or the Chief Commissioner or Commissioner, if so authorised by the Board may, by order in writing, transfer any appeal which is pending before a Deputy Commissioner (Appeals) and any matter arising out of or connected with such appeal and which is so pending, to the Commissioner (Appeals) if the Board or, as the case may be, the Director General, the Chief Commissioner or Commissioner (at the request of the appellant or otherwise) is satisfied that it is necessary or expedient so to do having regard to the nature of the case, the complexities involved and other relevant considerations and the Commissioner (Appeals) may proceed with such appeal or matter from the stage at which it was before it was so transferred:

Provided that the appellant may demand that before proceeding further with the appeal or matter, the previous proceeding or any part thereof be re-opened or that he be re-heard.

Appealable orders before Commissioner (Appeals) [Section 23A]

(1) Any person may appeal to the Commissioner (Appeals) against the assessment or order:

(a) objecting to the amount of net wealth determined under this Act.

(b) objecting to the amount of Wealth Tax determined as payable by him unde this Act.

(c) denying his liability to be assessed under this Act.

(d) objecting to any penalty imposed by the assessing officer under Section 18 or Section 18A.

(e) objecting to any order of the assessing officer under Sub-section (2) of Section 20.

(f) objecting to any penalty imposed by the assessing officer under the provision of Section 221 of the

Income-tax Act as applied under Section 32 for the purposes of Wealth Tax.

(g) objecting to any order made by the assessing officer under Section 22 treating him as agent of a person residing outside India.

(h) objecting to any order of the assessing officer under Section 35 having the effect of enhancing the assessment or reducing a refund or refusing to allow the claim made by the assessee under the said section, or

(i) objecting to any order of the Valuation Officer under Section 35 having the effect of enhancing the valuation of any asset or refusing to allow the claim made by the assessee under the said section, or (j) objecting to any penalty imposed by the Deputy Director or Deputy Commissioner under Section 18A. The application in duplicate, has to be in the prescribed form (form E) and verified in the prescribed manner and on payment of a fee of two hundred and fifty rupees.

Explanation: For the purpose of this sub-section where on or before 1st day of October, 1998, the post of Deputy Commissioner has been redesignated as Joint Commissioner and the post of Deputy Director has been redesignated as Joint Director the reference in this sub-section for "Deputy Commissioner" and "Deputy Director" shall be substituted by "Joint Commissioner" and 'Joint Director" respectively.

(2) Every appeal pending before the Deputy Commissioner (Appeals), immediately before the appointed day and any matter arising out of or connected with such appeal shall stand transferred to the Commissioner (Appeals) and he may proceed with such appeals or matter from the stage on which it was on that day. However, the appellant may demand that before proceeding further with the appeal or matter, the previous proceedings or

any part thereof be reopened or that he be reheard. Appointed day means the day appointed under Section

246A of the Income-tax Act.

(3) An appeal shall be presented when thirty days of the receipt of the notice of demand relating to the assessment or penalty objected to or the day on which any order objected to is communicated to him. The Commissioner (Appeals) may, however, admit an appeal after the expiry of the aforesaid period, if he is satisfied that the appellant had sufficient cause for not presenting the appeal within that period.

Section 23A further provides that appeal is admitted only if the assessee has paid the tax due on the net wealth

returned by him. In every appeal, the Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed under Section 23A(1). The order of Commissioner (Appeals) shall be in writing and shall state the points for determining the decision thereof and reasons for the decision and a copy of every order so passed shall be forwarded to the appellant and the Chief Commissioner or Commissioner. Order passed by the Appellate Tribunal on appeal shall be final except as provided in Section 27 or Section 27A.

APPEAL TO THE APPELLATE TRIBUNAL (SECTION 24)

Where the assessee is not satisfied by any of the following orders of the Commissioner (Appeals), he may file an appeal to the Appellate Tribunal within sixty days of the date on which the order is communicated to him:

(1) penalty under Section 18; or
(2) penalty under Section 18A; or
(3) order passed by the Commissioner (Appeals) under Section 23 or Section 23A; or
(4) imposing a fine under Section 37(2).

In the same way, if the Commissioner is not satisfied by the order of the Commissioner (Appeals), he may direct the Assessing Officer to appeal to the Appellate Tribunal against the order. The appeal shall be filed in the prescribed Form F and within 60 days of the date of which the order sought to be appealed against is communicated to the Commissioner. If the appeal is filed by the assessee, it shall accompany a fee of ` 1000. However, for appeal not relatable to net wealth as computed by the Assessing Officer, fee is ` five hundred.

After receiving the application from the aggrieved party in form F, the Appellate Tribunal shall issue a notice to the other party that an appeal against the order has been preferred. The other party may file a memorandum of cross objections in the prescribed Form G against the order within 30 days of the receipt of the notice. The memorandum of cross objections shall be treated as if it were an appeal presented by the other party. If the assessee or the Assessing Officer, as the case may be, fails to file the appeal or memorandum of cross objection in the prescribed time, the Appellate Tribunal may admit it after the expiry of relevant period if it is satisfied that there was sufficient cause for not presenting it within the prescribed time.

The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such order as it deems fit. However, it is not empowered to enhance the assessment or penalty without giving an opportunity to the assessee showing cause against such assessment. By amendment in this section Finance Act, 1999 has provided that in every appeal the Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed. It is further provided that the cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal.

A copy of the order passed by the Tribunal shall be forwarded to the assessee and the Commissioner. The decision of the Tribunal regarding the facts of the case shall be final.

REVISIONS OF ORDERS BY COMMISSIONER (SECTION 25)

The Commissioner can revise the orders passed by any authority subordinate to him under two circumstances:
(1) In the interest of assessee.
(2) In the interest of the revenue.

The Commissioner, either on his own motion or on an application by the assessee for revision, can call for the record of any proceeding under this Act which has been conducted by any authority subordinate to him (including the Appellate Assistant Commissioner). After making such enquiry as may be necessary, the Commissioner may pass such orders as he thinks fit. However, the order cannot be prejudicial to the assessee. The Commissioner is not empowered to revise any order on his own motion if a period of more than one year has expired from the date of the

order sought to be revised. If the application is made by the assessee for revision, it must be accompanied by a fee of ` 25 and it must be made within one year from the date of the order sought to be revised or within such further period as the Commissioner may think fit allow on being satisfied that the assessee was prevented by sufficient cause from making the application within the prescribed time. If the Commissioner refuses to interfere, it shall not be deemed an order prejudicial to the assessee. Further, the Commissioner shall not revise any order in the following cases:

(i) where an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal, the time within which such appeal can be made has not expired or in the case of an appeal to the Tribunal, the assessee has not waived his right of appeal.

(ii) where the order is the subject of an appeal before the Commissioner (Appeals) or the Tribunal. The Commissioner on his own motion, may call for and examine the record of any proceeding under this Act and if he considers that any order passed by the Assessing Officer is prejudicial to the interests of the revenue, he may, after giving the assessee a reasonable opportunity of being heard and after making or causing to be made the necessary enquiries pass such order as the circumstances of the case justify. At the time of revision, he can enhance or modify the assessment or cancel it and direct for a fresh assessment. However, no order shall be made after the expiry of 2 years from the date of the order sought to be revised. In respect of any application made on or after 1st October, 1998, it shall be obligatory on the Commissioner to pass an order within a period of one year from the end of financial year in which such application is made by the assessee for revision. But, an order in revision can be passed by the Commissioner at any time, in the case of any order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Tribunal, the High Court or the Supreme Court. Further in computing the period of two years, the time taken in giving an opportunity to the assessee to be re-heard (under Section 39) and any period during which proceeding under this section is stayed by an order of injunction of any court shall be excluded.

REFERENCE TO THE HIGH COURT (SECTIONS 27)

Section 27 provides for a reference on a question of law to the High Court. The assessee or the Commissioner may, within 60 days of the date on which he is served with an order of the Appellate Tribunal or the Commissioner [under Section 24 or 25 by application in the prescribed form 'H' require the Appellate Tribunal to refer to the High Court any question of law arising out of such order. A question will be said to arise out of the Tribunal's order only if it has been raised before or decide by the Tribunal.

However, no application shall be made to the Appellate Tribunal to make a reference to the High Court on or after 1st day of June 1999 as provided by Finance Act, 1999.

The Tribunal may accept an application within 30 days even after the expiry of the prescribed time (60 days) if it satisfied that the applicant

was prevented by sufficient cause from presenting the application within time.

If the application is made by the assessee for reference of the case to the High Court, it must be accompanied by a fee of ` 200. On receipt of an application for reference, the Tribunal shall state the case to the High Court within 120 days of the receipt of the application. Where the Tribunal refuses to state the case either on the ground that no question of law arises from its order, or that the application is time barred, the aggrieved party may apply to the High Court against the refusal by the Tribunal to state the case to it. In this case the application must be presented within 90 days from the date on which he is served with a notice of refusal or rejection. The High Court may admit an appeal even after the expiry of the period of one hundred and twenty days if it is satisfied that there was sufficient cause for not filing the same within that period.

If the court is not satisfied with the decision of the Tribunal, it may require the Tribunal to state the case and on
receipt of such requisition the Tribunal shall state the case. Where the assessee is satisfied on the Tribunal's refusal to state to the case on the ground that no question of law arises, he may, within 30 days from the date on which he receives notice of refusal, withdraw his application and if he does so, the fees paid by him shall be refunded to him.

Where the Tribunal is of the opinion that on account of conflict of decisions between the different High Courts in respect of any particular question of law, it is expedient to refer the question to the Supreme Court, it may refer the question to the Supreme Court through its President.

The Tribunal shall state the facts of the case, its own finding and the questions of law which are required for reference. If the Court finds that the statement does not set out all the points which might have been referred, it
may send the case back for making such necessary modifications as may be directed by the Court. The court, upon hearing the reference, shall decide the question of law raised therein and deliver the judgement containing the grounds on which decision is founded. A copy of the judgement shall be sent under seal of the court and the signature of the Registrar to the Tribunal. The Tribunal shall pass such orders as are necessary for disposing of the case conformably to such judgement. The costs of the reference to the court excluding the fee for making the reference shall be in the discretion of the court.

APPEAL TO HIGH COURT (SECTION 27A)

Section 27A has been inserted by Finance (No. 2) Act, 1998 to provide that an appeal shall lie to the High Court from every order passed on an appeal by Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law. An appeal can be made within 120 days of the date of service of relevant order.

The High Court may admit an appeal even after the expiry of the period of one hundred and twenty days if it is
satisfied that there was sufficient cause for not filing the same within that period. In an appeal under the new section, the Memorandum of Appeal

shall precisely state the substantial question of law involved in the appeal.
Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate the question. The appeal shall be heard only on the question so formulated and the respondent shall, at a hearing of the appeal, be allowed to argue such question. However, nothing in this section shall be deemed to take away or abridge the power of the court to hear for reasons to be recorded, appeal in any other substantial question of law not formulated by it, if it is satisfied that the case involves such question. The High Court decides the formulated question of law and deliver judgement containing the grounds on which such decision is founded. It may also award costs.
The assessing officer is required to give effect to the order of the High Court on the basis of a certified copy of the judgement delivered. In the case of appeal to High Court the provisions of the Code of Civil Procedure, 1908
apply.

Section 28 - Hearing by High Court

The case referred to or appeal filed to in the High Court shall be heard by a Bench of not less than two judges, the case is to be decided unanimously or where they differ, according to the opinion of the majority. Where the number of judges hearing the case is even and there is no majority in forming an opinion on a point the case shall be heard on that point only by one or more other judges of the Court. Such point shall then be decided according to the opinion of the majority of the judges who have heard the case, including those who first heard it.

APPEAL TO SUPREME COURT (SECTION 29)

An appeal may lie to the Supreme Court from any judgement of a High Court provided the High Court certifies the case to be a fit one for appeal to the Supreme Court. The High Court grants such certificate only if a substantial question of law is involved in the case or the question is likely to occur in future or if the question is otherwise of great public or private importance, if, however, the High Court decide not to give such a certificate, then the aggrieved party, may make an application to the Supreme Court under Article 136 of the Constitution of India.
The Supreme Court, after hearing the appeal, may either affirm, vary or reverse the decision of the High Court.
Accordingly, the decision of the supreme Court shall be sent to the Tribunal which shall pass such orders as are
necessary for disposing of the case in conformity with such judgement.

PENALTIES UNDER THE WEALTH-TAX ACT

The non-compliance with the various provisions of Wealth-tax Act, Sections 15B(3), 18, 18A and 32 provide for the levy of penalty on the assessee. In addition, Sections 35A to 35L contain provisions under which an assessee might be prosecuted for certain offences under the Wealth-tax Act. The various terms of penalty are described below:

(1) Penalties Imposable under Wealth-tax Act

The various items of penalties imposable and prosecutions under the Wealth-tax Act, are as under:

Section Nature of default Penalty/Fine
(A) (B) (C)
15B(3) Failure to pay tax or interest payable on Liable for penalty by deeming assessee toself-assessment be in default (Not exceeding 100% of tax in arrears)
18(1)(ii) Failure to comply with notice under Minimum : ` 1,000 for each failure section 16(2) or (4) without reasonable Maximum : ` 25,000 for each failure cause
18(1)(iii) Concealment of wealth Minimum : 100% of tax sought to be avoided
Maximum : 500% of tax sought to be avoided
18A(1)(a), (b) Failure to answer questions (i) legally Minimum : ` 500 for each failure/default
and (c) bound or (ii) sign statements legally Maximum : ` 10,000 for each failure/default
required or (iii) comply with summons under section 37(1) without reasonable cause.
18A(2) Failure to furnish in due time statement/ Manimum : ` 100 for every day of default information required under section 38 Maximum : ` 200 for every day of default without reasonable cause.
32 Committing default in payment of tax Not exceeding 100 per cent of tax in arrears
PROSECUTIONS
35A(1) Wilful attempt to evade tax, penalty or 6 months rigorous imprisonment which interest: in case amount sought to be may extend to 7 years and fine without evaded exceeds ` 1,00,000 prejudice to penalty imposable under any other provision of the Act.
in any other case 3 months rigorous imprisonment which may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act.
35A(2) Wilful attempt to evade payment of tax, 3 months rigorous imprisonment which penalty or interest may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act.
35B Wilful failure to furnish in due time return of wealth in terms of section 14(1) or 14(2) or 17 (1)- (a) in case where tax sought to be 6 months rigorous imprisonment which evaded exceeds ` 1,00,000 may extend to 7 years and fine
(b) in any other case 3 months rigorous imprisonment which may extend to 3 years and fine
Note: Prosecution is not to be resorted to in cases where return is furnished before end of assessment year or tax determined on regular assessment does not exceed ` 3,000 35C Wilful failure to produce accounts/records Up to 1 year rigorous imprisonment or fine in terms of section 16(4) between ` 4 and ` 10 for every day of default or with both
35D Filing of false statement in verification (other than under Section 35AB regarding registration of valuers)/delivering false statement-
(a) in case where tax sought to be 6 months rigorous imprisonment which evaded exceeds ` 1,00,000 may extend to 7 years and fine (b) in any other case 3 months rigorous imprisonment which may extend to 3

years and fine 35E Making false statement in verification Imprisonment up to 6 months or fine or both mentioned in section 35AB 35EE Failure without reasonable cause, to Rigorous imprisonment up to 2 years and furnish particulars under section 35ACC fine regarding intimation by registered valuer of his conviction of any offence 35EEE Making contravention of order made under Up to 2 years rigorous imprisonment and section 37A/(3A) fine. 35F Abetting or inducing another person to make and deliver false accounts, statement or declaration relating to net wealth chargeable to tax: (a) in case where tax, etc. sought to be 6 months rigorous imprisonment which evaded exceeds ` 1,00,000 may extend to 7 years and fine (b) in any other case 3 months rigorous imprisonment which may extend to 3 years and fine 35G Second and subsequent offences under 6 months rigorous imprison-ment which sections 35A(1), 35B, 35D or 35F may extend to 7 years and with fine *Note: Prosecution has to be initiated with the previous sanction of specified wealth-tax authorities who have also power to compound offences vide section 35 The student should also note that by virtue of the provisions of Sections 34A and 37C, as amended : (a) interest @ for every month or part of the month on the refund due on the assessee is payable to him by the Wealth-tax authorities for the period specified in Section 34A, and (b) interest @ 15% per annum is payable by the Central Government on the surplus remaining after the application of the assessee's assets by the assessing authorities towards recovery of the Wealth-tax due from him (for the period specified in Section 37C). Failure to furnish return on time is not a continuing default. The quantum of penalty will be determined in accordance with the provisions as they stood on the date on which the return was due. [C.W.T. v. Mor Shrikant Ramnaryan. (1984) 147 I.T.R. 412].

Section 18 provides for penalty for failure to furnish returns to comply with notice and concealment of assets etc. If the Assessing Officer, Commissioner (Appeals), Chief Commissioner or Commissioner or Appellate Tribunal, in the course of any proceeding under the Wealth-tax Act is satisfied that any person has failed to: (i) comply with the notice under Sub-sections (2) or (4) of Section 16, or (ii) has concealed the particulars of any assets or furnished inadequate particulars of any assets or debts, he or it may, by an order in writing, direct that such person shall pay, in the case of (i) hereinabove, in addition to the amount of Wealth-tax payable by him, the penalty which may be minimum of ` 1,000 and maximum ` 25,000. The penalty payable in the case of (ii)
hereinabove is minimum the amount of tax sought to be evaded by reason of concealment of the particulars of any assets or furnishing of inadequate particulars in respect of any assets or funds. The maximum penalty imposable in this case is five times the amount of tax sought to be evaded. In the case of non-compliance with the notice under Section 16(2) or (4), the penalty is not imposable if the person proves that there was reasonable cause for the failure referred to thereunder. Explanation 3 to Sub-section (1) provides that where any person, who is not previously assessed under the Wealth-tax Act fails, without reasonable cause, to furnish within the time limit for completion of assessment (Section 17A), the return of his net wealth in respect of assessment year 1989-90

onwards and till the expiry of the time limit relevant thereto (two years) no notice has been issued to him by the assessing authority and the concerned assessing authority is satisfied that in respect of such assessment year, such person is assessable for Wealth-tax, he shall be deemed to have concealed the particulars of his assets or furnished inadequate particulars of any asset or debt in respect of such assessment year, even if such person has furnished the return of his net wealth at any time after the expiry of the applicable periods under Section 17. In this case, the amount of 'tax sought to be evaded' means the tax assessed on the net wealth. In any other case, it means the difference between the tax on the net wealth assessed and the tax chargeable on the wealth disclosed by the assessee.

Further, in the case of failure of an assessee to offer an explanation in respect of any facts material to the computation of his net wealth or the explanation offered by him being found by the concerned assessing authority to be false or where he is not able to substantiate his explanation and fails to prove the bona fides of such explanation, the consequential deduction or disallowance in computing his net wealth shall be deemed to represent the value of the assets in respect of which the particulars have been concealed.*

Any bullion, money, jewellery or other valuable article or thing found in the course of search and claimed by the assessee as forming or representing parts of his net wealth are deemed to have been concealed by him if the assets have not been declared in the return of wealth furnished before the date of search for the valuation date falling before or after the date of search unless the assets are recorded either before the date of search or specified in the books of account maintained by him or disclosed to the Commissioner before the date of search or the assessee declares such assets in the course of search, specifies the manner of acquisition thereof and pays tax and penalty thereon.

Explanation 6 clarifies that the circumstance where any additional tax is charged as a consequence of rectification of arithmetical error, exemptions or deductions allowed/disallowed on the basis of the information available in the return of wealth does not tantamount to concealment.

Sub-section (3) makes the prior approval by the Joint Commissioner compulsory for the following cases : (i) where the penalty exceeds ` 10,000 and the concerned assessing authority is the Income-tax Officer; (ii) where the penalty exceeds `20,000 and the concerned assessing authority is the Assistant Commissioner or Deputy Commissioner.

Sub-section (5) lays down that no order imposing the penalty under this Section shall be passed in a case where the assessment to which the proceedings for imposition of penalty relate is the subject matter of an appeal under Section 23 or 24; after the expiry of the financial year in which the proceedings, in the course of which action for imposition of penalty has been initiated, are completed or 6 months from the end of the month in which the order of assessing authority i.e. the Commissioner (Appeals) or ITAT is received by the Chief Commissioner or Commissioner whichever is later. Where the relevant assessment is subject matter of revision under Section 25(2), the order imposing

penalty shall not be passed after the expiry of six months from the end of the month in which such order or revision is passed. In any other case, the penalty order cannot be passed after the expiry of the financial year in which the proceedings in course of which action for imposition of penalty has been initiated, are completed or six months from the end of the year in which action for imposition of penalty is initiated, whichever period expires later.

In computing the above periods of limitation, the period during which immunity is granted under Section 22H; the time taken in giving an opportunity to the assessee to be reheard under Section 39 and the period during which a proceeding for levy of penalty is stayed by an order or injunction of any court shall not be taken into account.

(2) Failure to Pay Tax (Section 31)

When an assessee fails to pay tax demanded of him during the prescribed time (30 days), he shall be liable byway 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.

POWER TO REDUCE OR WAIVE PENALTY (SECTION 18B)

The Commissioner is empowered to reduce or waive the amount of penalty imposed or imposable on an assessee either on his own motion or otherwise, in the following cases:

(i) Concealment of the particulars of his wealth or furnishing of inaccurate particulars of assets or debts. The Commissioner would reduce or waive the penalty subject to the following conditions :

(i) in case of (i) above, the assessee has furnished particulars regarding the concealed wealth or particulars in respect of any asset or debt voluntarily and in good faith prior to the detection by the Assessing Officer of the concealment or inaccurate particulars of assets or debts.

(ii) he has co-operated with the department in any enquiry relating to assessment.

(iii) he has paid or made satisfactory arrangements for the payment of tax or interest payable in respect of the relevant assessment year.

Where the assessee conceals the particulars of his wealth and the amount of wealth so concealed for any one of the relevant assessment years exceeds ` 5,00,000, the Commissioner cannot reduce or waive the penalty, without the previous approval of the Chief Commissioner or Director General. However, where the Commissioner has reduced or waived the penalty once in relation to one or more assessment years, the assessee shall not be entitled to any relief again for other assessment years. Further, Section 18B(4) empowers the Commissioner to grant relief to an assessee on his application and after recording the reasons for doing so by (i) reducing or waiving every kind of penalty payable under the Wealth-tax Act, or (ii) staying or compounding recovery proceedings in respect thereof. This right should be exercised by the Commissioner in deserving cases which satisfy the following conditions:

(i) if it is not done, it would cause genuine hardship to the assessee, and

(ii) the assessee has co-operated in any inquiry relating to assessment or recovery proceedings.

An order of the Commissioner (under Section 18B) reducing or waiving the penalty shall be final and shall not be called into question before any court or any other authority.

OFFENCES AND PROSECUTIONS (SECTIONS 35A TO 35N)

There are certain lapses on the part of the assessee for which the wealth-tax authority at the instance of the Commissioner, may launch prosecution proceedings against him in the court. In that case the Magistrate (Metropolitan or first class) shall penalise the assessee and not the department. However, the Commissioner may, either before or after the institution of proceedings compound any offence.

The prosecution proceedings may be instituted against the defaulter assessee in various cases explained in the succeeding paragraph, other than these sections which are already discussed (Section 35A to Section 35G):

(1) Wilful Attempt to Evade Tax etc. (Section 35A)

If a person 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 hall be punishable with both penalty and prosecution. For details see the Table under heading IX hereinbefore. However, a person shall not be proceeded against for failure to furnish in due time the return of net wealth under Section 14(1) in the following cases :

(a) for any assessment year commencing prior to 1.4.1975;

(b) for any assessment year commencing after 31.3.1975; if

(i) the return is furnished by him before the expiry of the assessment year; or

(ii) the tax payable by him, determined on regular assessment, does not exceed ` 3,000.

(3) Failure to Produce Accounts and Documents (Section 35C)

If a person wilfully fails to produce accounts, records and documents referred to in a notice issued under Section 16(4) on the date specified in the notice, he shall be punishable with rigorous imprisonment as well as fine. (See the Table under heading IX hereinbefore)

(4) False Statement in Verification (Section 35D)

If a person makes a statement in any verification (other than the registration of valuer) or delivers an account or statement which is false,

and which he knows to be false or does not believe to be true, he shall be punishable with prosecution/penalty highlighted under heading IX hereinbefore.

(5) False Statement in Verification by Registered Valuers (Section 35E)

If a Registered Valuer makes a statement in verification which he either knows or believes to be false, or does not believe to be true, he shall be punishable with imprisonment for a term which may extend to 6 months or with fine or with both. (Also given in Table under heading IX hereinbefore.)

(6) Failure to furnish particulars under Section 34ACC (Section 35EE)

If a person referred to in Section 34ACC, i.e., a registered valuer, fails to intimate to the Board the particulars of conviction or finding referred to in the said section, he shall be punishable with rigorous imprisonment and also be liable to fine. But, if such person proves that there was reasonable cause or excuse for the said failure, he shall not be punishable. (For details see the Table under heading IX hereinbefore.

(7) Contravention of order made under Section 37A (Section 35EEE)

Section 35EEE, provides for punishment with rigorous imprisonment (See Table under heading IX) and also imposition of fine in the event of contravention of the provisions of Section 37A, second proviso to Sub-section (1) and sub-section (3A) [pertaining to orders of the Assessing Officer to assessee not to remove, part with or otherwise deal with the immovable properties, except with the previous permission of the concerned officer].

(8) Abetment of False Return, etc. (Section 35F)

If a person abets or induces any other person to make and deliver an account, statement or declaration relating to any net wealth chargeable to tax which is false and which he either knows to be false or does not believe to be true, or induces any person to evade tax, he shall be punishable with prosecution and fine specified under heading IX.

(9) Punishment for Second and Subsequent Offences (Section 35G)

If any person convicted of an offence mentioned in 1, 2, 4 and 7 above is again convicted of the same offence, he shall be punishable for the second and every subsequent offence with rigorous imprisonment for at least 6 months but which may extend to seven years and with fine.

(10) Offences by H.U.F. (Section 35H)

Where an offence under this Act has been committed by a H.U.F., the karta thereof shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence, he shall not be punished. Where it is proved that the offence has been committed with the consent or connivance of or is attributable to any neglect on the part of any member of the family, such member shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(11) Offences by companies (Section 35HA)

The Finance Act, 1992 has inserted this new Section 35HA with effect from the assessment year 1993-94. As companies have also been brought under the wealth tax net with effect from assessment year 1993-94 this new Section 35HA lays down the penalty where an offence has been committed by a company. Thus according to this section every person who at the time the offence was committed, was incharge of and was responsible to the company for the conduct of the business of the company as well as the company will be liable to be proceeded against and punished accordingly.

However, no such person shall be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Further, this section also defines the term 'company' to include a firm and an association of persons or body of individuals whether incorporated or not.

W.e.f. 1.10.2004, where an offence has been committed by a Person, being a company and such offence is punishable with imprisonment and fine, then without prejudice to the aforesaid provisions such company shall be punishable with fine and every person referred to in sub-section (1) or the director, manager, secretary or other officer of the company referred to in sub-section (2), shall be liable to be proceeded against and punished in accordance with the provisions of this Act.

(12) Prosecutions to be at the instance of Chief Commissioner or Commissioner and power of Chief Commissioner to compound offences (Section 35-I)

A person shall not be proceeded against for an offence under the Wealth-tax Act, 1957 except with the previous approval of the Commissioner or Commissioner (Appeals). The Chief Commissioner/Director General have been empowered to issue such instructions/directions with regard to prosecution matters as they may deem fit. They have also been empowered to compound any offence either before or after the institution of proceedings.

(13) Certain offences to be non-cognizable (Section 35J)

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, an offence punishable under Section 35A or Section 35B or Section 35D or Section 35F shall be deemed to be non-cognizable within the meaning of that Code.

(14) Bar on Prosecution (Section 35K)

A person shall not be prosecuted for an offence under 1 and 4 above (Sections 35A and 35D) in relation to the assessment for an assessment year in respect of which the penalty imposed or imposable under Section 18(1)(iii) has been reduced or waived under Section 18B. Further, any statement made or account or other document produced by the offender before any wealth-tax authority, not being an Inspector of Income-tax, shall not be inadmissible as evidence for prosecution proceedings merely on the ground that it was made or produced in the belief that the penalty would be reduced or waived or the offence would be compounded.

(15) Jurisdiction of Courts (Section 35L)

No court inferior to that of a Metropolitan Magistrate or a Magistrate of the first class shall try any offence under this Act.

(16) Section 360 of the code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958 not to apply (Section 35M)

Nothing contained in Section 360 of the Code of Criminal Procedure, 1973, or in the Probation of Offenders Act, 1958, shall apply to a person convicted of an offence under this Act unless that person is under eighteen years of age.

(17) Immunity from Prosecution (Section 36A)

The Central Government may grant immunity to potential supplier of valuable information, data and evidence on the basis of which tax-evaded wealth may be discovered and due taxes, penalty, etc., recovered from the taxevader 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 wilfully 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.

REVIEW 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. What do you understand by "converted property"? How much share of the "converted property" shall be included in the net-wealth of transferor after partition of the H.U.F.? Illustrate.
5. In what circumstances is the value of property transferred to a spouse, of the transferor includible in the transferor's net-wealth?
6. Who is liable to pay wealth-tax after the partition of a Hindu Undivided Family?
7. Write short note on Payment and Recovery of Wealth-tax under the Wealth-tax Act.
8. Who can rectify a mistake and at whose request? Mention the time limit for rectification of a mistake.
9. 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?
10. 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?

FURTHER READINGS

1. Taxation Law And Practice- V. Balachandran, S. Thothadri
2. Direct Taxes - Law & Practice-Dr. V. K. Singhania/Dr. Kapil Singhania
3. Income Tax: Law & Practice-Hariharan

4. India: Commercial Law, Customs, And Taxation-Germano Franceschin, Francesco Misuraca.
5. Handbook Of Taxation Laws Of India-P.L.Malik

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5. Handbook Of Taxation Laws Of India-P.L.Malik
6. Student's Guide To Income Tax 2005-06-Monica Singhania Dr Vinod K. Singhania.