DIRECT TAX

MODULE I

Relevant for May 2018 / Nov 2018 Exam

CA MEHUL THAKKER

ASSESSMENT YEAR 2018-19

Special Thanks to CA Chetan V Chaudhary

Law stated in this book is as amended by the Finance Act, 2017

MASTER INDEX

DIVISION A

BASICS, RESIDENTIAL STATUS, EXEMPT INCOME

INDEX

1 – BASICS OF INCOME TAX

1.1 PRELIMINARY

Section:- 1

The Act is to be called as "The Income-tax Act, 1961" and it extends to the whole of India. It came into force on the 1st day of April, 1962.

1.2 CHARGE OF INCOME-TAX

Section:- 4

Section 4 is the charging section. It provides as under:

- Income-tax is levied on the "total income" of every person.
- Normally, income of previous year is chargeable to tax in the relevant assessment year.
- Tax rates are fixed by the Annual Finance Act.
- "Total income" shall be computed in accordance with the provisions of the Act.

1.3 SOME IMPORTANT DEFINITIONS

Section:- 2 and 3

(a) Person [Section 2(31)]

The term "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; and
- Every artificial juridical person, not falling within any of the preceding categories.

(b) Assessment Year [Section 2(9)]

Assessment year means the period of twelve months starting from April 1 of every year and ending on March 31 of the next year. For e.g. the assessment year 2015-16 which commenced on April 1, 2015, and it will end on March 31, 2016.

(c) Previous Year [Section 3]

- Previous year means the financial year immediately preceding the assessment year. Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year and the next year in which income is taxable is known as assessment year. In other words, it can be said that income earned during the previous year 2017-18 is taxable in the immediately following assessment year **(*i.e.,* 2018-19)**.

- Previous year in the case of newly set-up business/profession or new source of income – The first previous year of newly set up business/profession will commence on the date of setting up of business; ending with the last day of financial year.

  EXAMPLE: If new business is set up on 21-10-17 then the first previous year for that business will be period starting from 21-10-17 to 31-03-18. And, therefore A.Y. is **2018-19**.
- The same rule is applicable for the new source of income coming into existence during the previous year.

(d) Income [Section 2(24)]

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

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

(i) Profits and gains.

(ii) Dividends.

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

(iv) The value of any perquisite or profit in lieu of salary taxable under section 17.

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

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

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

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

(ix) Deemed profits chargeable to tax under section 41 or section 59.

(x) Profits and gains of business or profession chargeable to tax under section 28.

(xi) Any capital gains chargeable under section 45.

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

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

(xiv) Any 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. For this purpose,

(a) "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;

(b) "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.

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

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

(xvii) "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former's business.

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

(xix) Any consideration received for issue of shares as exceeds the fair market value of the shares [section 56(2)(viib)].

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

(xxi) Any sum of money or value of property received without consideration or for inadequate consideration by any person [section 56(2)(x)].

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

(e) Total Income [Section 2(45)]

Total income of an assessee means gross total income [--] deduction u/s 80C to 80U.

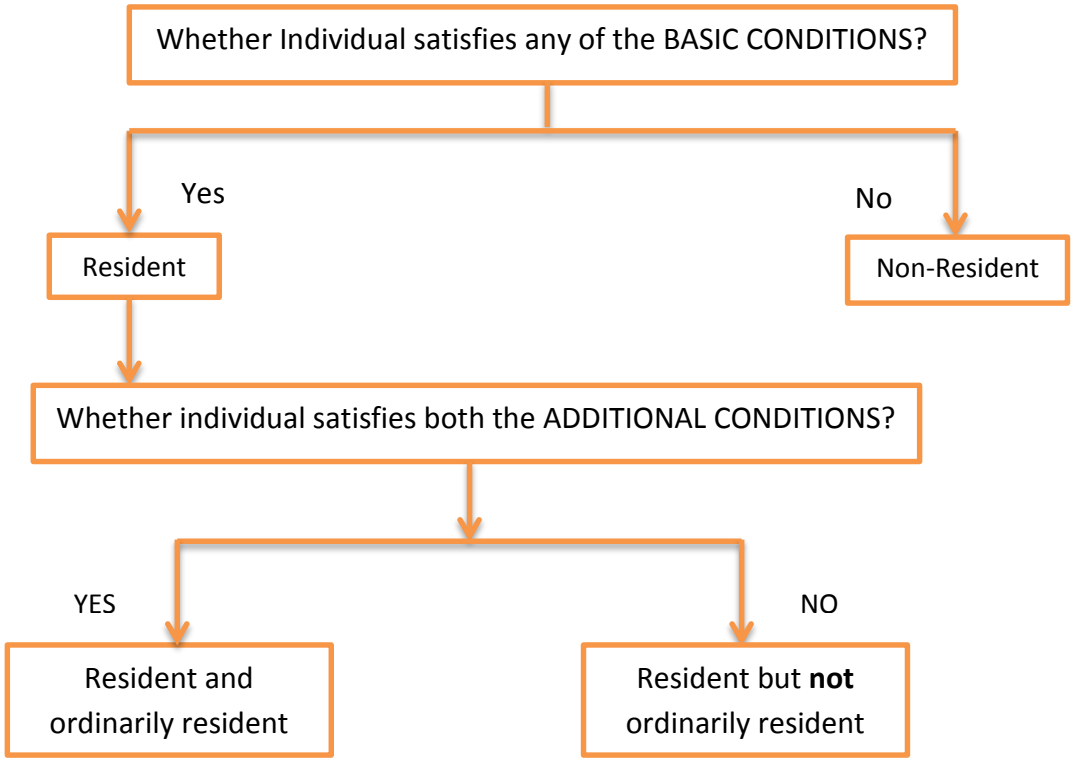
(f) India [Section 2(25A)]

"India means the territory of India as referred to in article 1 of the constitution, its territorial waters, seabed and subsoil underlying such waters, continental self, exclusive economic zones or any other maritime zone as referred to in the Territorial Waters, Continental Self, Exclusive Economic Zones or any other Maritime Zone Act, 1976 and the air space above its territory and territorial waters.

1.4 HOW TO DETERMINE RESIDENTIAL STATUS OF A PERSON?

Section:- 6(1)

(1) In case of Individual [Section 6(1)]



- **Let's understand Basic Conditions**

  (a) He is in India at least for 182 days during the previous year.

  Or

  (b) He is in India for at least 60 days during the previous year and 365 days during 4 years immediately preceding the concerned previous year.

> **How to count presence in India (days)?**
>
> **(a)** If timings of arrival in India as well as departure from India are available, then presence in India shall be computed on hourly basis and thereafter total of 24 hours of stay in India shall be taken as one day.
>
> **(b)** If such timings are not available, then day on which he enters India as well as day on which he leaves India, both days shall be taken into account.

- **Explanations to Basic Conditions (Popularly known as exceptions to the Basic Conditions)**

  (a) In case of an individual, being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship or for the purposes of employment outside India, **then only basic condition to be checked is :- Condition mentioned at point no. (a)**.

(b) In case of an individual, being a citizen of India, or a person of Indian origin, who, being outside India, comes on a visit to India in any previous year, then **only basic condition to be checked is :- Condition mentioned at point no. (a)**.

(c) Person of Indian Origin: -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.

- **In the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the manner and subject to such conditions as may be prescribed. (see notification below).**

Notification No. 70/2015/ F.No.142 /12/2015-TPL Dated 17.08.2015

Computation of period of stay in India in certain cases. -

(1) For the purposes of clause (1) of section 6, in case of an individual, being a citizen of India and a member of the crew of a ship, the period or periods of stay in India shall, in respect of an eligible voyage, **not include the period computed in accordance with sub-rule (2).**

(2) The period referred to in sub-rule (1) shall be the **period beginning on the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible Voyage and ending on the date entered into the Continuous Discharge Certificate in respect of signing off** by that individual from the ship in respect of such voyage.

- **Now let's move to Additional Conditions**

(a) He has been resident at least for 2 years out of 10 years immediately preceding the concerned previous year

AND

(b) He has been in India for at least 730 days during 7 years immediately preceeding the concerned previous year

- **As per the provisions of section 6(5) of the Act,** if a person is resident in India in a previous year in respect of any source of income, he shall be deemed to be resident in India in the previous year in respect of each of his other sources of income

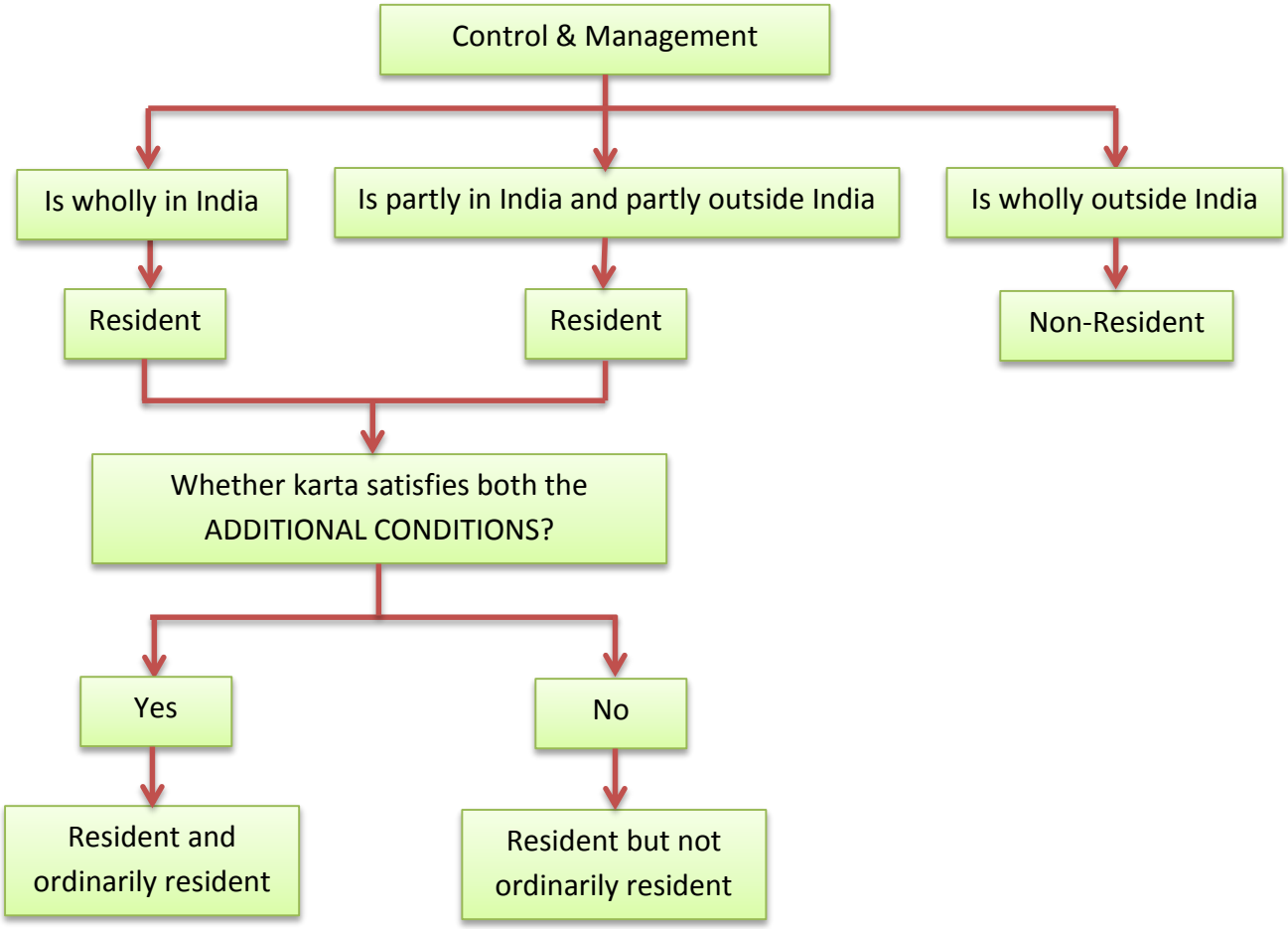
(2) In case of Hindu Undivided Family [Section 6(2)]

- **When a Hindu undivided family is resident or non-resident?**

The residential status of a Hindu undivided family depends upon the fact that where the control and management of its affairs is situated? Following chart highlights the rules for determining the residential status of a Hindu undivided Family: -

- **What is "Control and Management"?**

Control and management is situated at a place where the head, the seat and the directing power are situated.



(3) In case of Firm and Association of Persons (AOP) [Section 6(2)]

- A partnership firm and an association of persons are said to be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. They are, however, treated as non-resident in India if control and management of their affairs are situated wholly outside India.
- The following Chart summarizes the rules for determining residential status of the firm and association of persons—

Place of control	**Resident or Non-resident?**
Control and management of the affairs of a firm/association of persons is-	
1. Wholly in India	Resident
2. Partly in India and partly outside India	Resident
3. Wholly outside India	Non-resident

(4) In case of a Company [Section 6(3)]

- A company is said to be resident in India in any previous year, if—
  (i) it is an Indian company; or
  (ii) its place of effective management, in that year, is in India.

Explanation:- *For the purposes of this clause "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made.*

- The table given below highlights the rules for determining the residential status of company —

Place of effective management	Resident or non-resident?	
	An Indian Company	**A company other than an Indian company**
Place of effective management is-		
1. in India	Resident	Resident
2. not in India	Resident	Non- Resident

(5) In case of a Every Other Person [Section 6(3)]

Place of control	Resident or non-resident?
Control and management of the affairs of every other person is -	
1. Wholly in India	Resident
2. Partly in India and partly outside India	Resident
3. Wholly outside India	Non Resident

1.5 SCOPE OF TOTAL INCOME

Section:- 5

Section 5 of the Income Tax Act, 1961 governs the scope of total income. It depends on residential status of person. Consider the following chart depicting incidence of tax.

Rule No.	Particulars	Whether tax incidence arises in the case of		
		Resident and ordinarily resident	**Resident but not ordinarily resident**	**Non-resident**
(A)	Income *received* in India whether accrued in India or outside India	Yes	Yes	Yes
(B)	Income *deemed to be received* in India whether accrued in India or outside India	Yes	Yes	Yes
(C)	Income *accruing or arising* in India whether received in India or outside India	Yes	Yes	Yes
(D)	Income *deemed to accrue or arise* in India whether received in India or outside India	Yes	Yes	Yes

	(Section 9 : Detailed discussion is given in para 3)			
(E)	Income received and accrued outside India from a business controlled in or a profession set-up in India	Yes	Yes	No
(F)	Income received and accrued outside India from a business controlled from outside India or a profession set-up outside India	Yes	No	No
(G)	Income (other than business or profession income) received and accrued outside India	Yes	No	No

For detail discussion on section 5, 6 and 9

Refer Module IV - Chapter 54

2 – INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

2.1 INCOMES EXEMPT FROM TAX

Section:- 10

Incomes which do not form part of total income are discussed under the various chapters:

Chapter No.	Chapter Name	Section
3	Salary	10(5), 10(10), 10(10AA), 10(10B), 10(11), 10(12), 10(13), 10(13A), 10(14)
5	Profits and Gains from Business or Profession	10(10C), 10(10CC)
6	Capital Gains	10(33), 10(37), 10(37A), 10(38)
11	Computation of Total Income and Tax Liability	10(1)
18	Taxation of Business Trusts	10(23DA), 10(23FBA), 10(23FBB), 10(23FC), 10(23FCA), 10(23FD)
54	Basics of International Taxation	10(4)(i), 10(4)(ii), 10(4B), 10(6)(ii), 10(6)(vi), 10(6)(viii), 10(6)(xi), 10(6A), 10(6B), 10(6BB), 10(6C), 10(7), 10(8), 10(8A), 10(8B), 10(9), 10(15A)
-	Current Chapter	Remaining

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(2)	Member of HUF	Any sum received from HUF	(a) Such sum is paid out of income of HUF or (b) In case of impartible estate, such sum is paid out of income of the estate belonging to family
10(2A)	Partner of the firm	Share of profit in total income of the firm	The firm is separately assessed to tax as such. Then, amount of exemption is as under: Total Income of Firm× $\frac{\text{Partner's share in the profits of the firm as per partnership deed}}{\text{Total profits of the firm}}$
10 (10BB)	Any person	Any payment received under Bhopal Gas Leak Disaster (Processing of Claims Act), 1985	In case if the assessee is allowed deductions under the IT Act for any payment in connection with any loss or damage caused by such disaster, the same shall not be exempt under this clause.
10(10BC)	Any individual or his legal heirs	Any compensation received from state or central government on account of any disaster	In case if the assessee is allowed deductions under the Income Tax Act for any payment in connection with any loss or damage caused by such disaster, the same shall not be exempt under this clause. **Refer Practical 7**
10(10D)	An individual	Amount received under life insurance policy including any bonus allowed on such policy	The following amount received shall not be allowed as exemption under this clause: (1) u/s 80DD(3) or 80DDA(3) (2) keyman insurance policy (3) Any sum received under an insurance policy in respect of which the premium payable for any of the years during the term of policy exceeds 20% of actual sum assured. [Before 1.04.2012] (4) Any sum received under an insurance policy in respect of which the Premium payable exceeds 10% of actual sum assured. [on or after 1.04.2012] (5) Any sum received under an insurance policy issued in case of person suffering from disability/disease u/s 80U and u/s 80DDB in respect of which the Premium payable exceeds 15% of actual sum assured. [on or after 1.04.2013] (6) Any sum received on death of a person under point (3), (4) and (5) is exempt. **Refer Practical 8**

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(11A)	An individual	Any payment from an account, opened in accordance with the Sukanya Samriddhi Account Rules, 2014 made under the Government Savings Bank Act, 1873 (5 of 1873)	-
10(12A)	Employee	40% of total amount payable to him is exempt.	Such amount is payable to employee at the time of closure of his account under NPS or opting out of the pension scheme referred to in section 80CCD - **Refer Practical 9**
10(12B) Inserted by Finance Act, 2017 w.e.f. A.Y. 2018-19	Employee	Any payment from NPS to an employee on partial withdrawal	**(1)** Withdrawal is made in accordance with the terms and conditions, specified under the Pension Fund Regulatory and Development Authority Act, 2013 and **(2)** Exemption shall not exceed twenty-five percent of the amount of contributions made by him. **Refer Practical 10**
10(15) (i)	All assessees	Interest, premium on redemption, securities, Bonds, certificates, as notified by government	Notifications issued under this clauses are:- • SO 607(E), dt. 9-6-1989 • SO 653(E) dt. 31.8.1992 • SO 844(E) dt. 21-9-1998 • SO 742(E) dt. 27.6.2003 • SO 1114(E) dt. 10-8-2005 281 / 2004 / F No. 178 /20 /2004 dated 18-11-2104
10(15) (iib)	Individual or HUF	Interest on notified capital bond	No Bond shall be notified after 1-6-2002. Notification issued under this clause • SO 413(E) Dt. 11-6-1982
10(15) (iic)	Individual or HUF	Interest on notified relief Bonds	Notification issued under this clauses are:- • F 4(9) W&M/2003 dt.. 13.3.2003 • F 4(9) W&M/2003 dt. 9-7-2004 • F 4(5) W&M/2002(i) dt. 28.2.2003 • F 4(13) W&M/2002 dt. 28.2.2003

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(15) (iid)	Individual non-resident Indian	Interest on notified Bonds	**1.** Person receiving such bonds as nominee, or survivor or gift from such NRI is also entitled to benefit under this clause. **2.** The NRI should invest in the bond in foreign exchange and on maturity the amount shall not be entitled to be repatriated **3.** Benefit would not be withdrawn if the NRI becomes resident of India. **4.** Where the bond is encashed before maturity, exemption would not be allowed for said previous year. Government shall not notify any such bonds after 1-6-2002.
10(15)(vi)	All assessees	Interest on gold deposit bonds issued under the Gold Deposit scheme, 1999 or deposit certificate issued under Gold Monetisation Scheme, 2015	-
10(15) (vii)	All assessees	Interest on Bonds	Bonds issued by local authority or state pooled finance entity as specified by the central govt.
10(15) (viii)	Person who is non- resident or not ordinary resident	Interest on offshore Banking units	1. Deposits made on or after 1-4-2005 shall be eligible for exemption. 2. Deposit is made in offshore banking unit as defined in section 2(u) of SEZ Act,2005
10(16)	An individual	Scholarship	• Scholarship is granted to meet cost of education • It is not necessary the same is granted by the Govt. • If the whole object of the payment is to meet cost of education, then no further inquiry is called for in order to exclude the amount from taxable income under section 10(16). **[CIT vs. V.K. Balachandran [1984]147 ITR 4 (Mad).).**

<table>
<tr><th>Sec.</th><th>Eligible Assessee</th><th>Nature Of Income</th><th>Conditions/Definitions/Comments</th></tr>
<tr><td>10(17)</td><td>A member of parliament or state legislature or any committee formed the reof</td><td>Daily allowances or constituency allowance</td><td>
<table>
<tr><th>Nature of Allowance</th><th>Exemption in the case of Members of Parliament</th><th>Exemption in the case of Members of State Legislature</th></tr>
<tr><td>Daily Allowance</td><td>Entire Amount</td><td>Entire Amount</td></tr>
<tr><td>Any other allowance received by a Member of Parliament under the Members of Parliament (Constituency Allowance) Rules, 1986</td><td>Entire amount is exempt</td><td>NA</td></tr>
<tr><td>Constituency allowance received by a member of State Legislature</td><td>NA</td><td>Entire amount from the A.Y.07-08.</td></tr>
</table>
Remark: Whether remuneration/allowances paid to the assessee as a MP/MLA is taxable under the head “Income from salary”? –
While answering this question, Rajsthan High Court in case of CIT v. Shive Charan Mathur (2008) 306 ITR 126 observed that MPs and MLAs cannot be considered as employees as they are not employed by anybody but are elected by the public from their respective constituencies and discharge constituency functions. Hence, salary and allowances received by them cannot be taxed under the head ‘salary', but are taxable under the head ‘income from other sources'.
</td></tr>
<tr><td>10(17A)</td><td>Any assessee</td><td>Award or Reward received in cash or in kind</td><td>Award received should be given in public interest by Central or State government or any other body and approved by Central Government.</td></tr>
<tr><td>10(18)</td><td>Any eligible Central or state government employee</td><td>Pension or family pension received by the family member as the case may be</td><td>The eligible employee has been awarded Param Vir Chakra, or Maha Vir Chakra, or Vir Chakra or any other notified gallantry awards by Central Government.</td></tr>
</table>

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(19)	Widow, children or nominated heir of member of army	Family pension received	The member of armed force or paramilitary force should have died in the course of operational duty under prescribed circumstances. [Refer Rule 2BBA for prescribed circumstances]. **Refer Practical 11**
10(19A)	Any Ruler	Annual value of any palace/s in occupation of such Ruler.	Exemption is limited to a palace in occupation of the ex-ruler. If part let out, exemption is limited to that portion of palace which is in occupation of the ex-ruler. **[Maharaval Lakshman Singh vs. CIT [1986] 160 ITR 103 (Raj.)]**
10(20)	Income of panchayat, municipality, municipal committee, district Board or cantonment board (Local authority)	Income from house property, capital gains, Income from trade or business and Income from other sources	Income from trade or business shall accrue • from supply of commodity or services other than water and electricity in its area; or • From supply of water or electricity within or outside its jurisdictional area.
10(21)	Any Research Association	Any income	**1.** The research Association shall be approved u/s 35(1)(ii)/35(1)(iii). **2.** It applies or accumulates the income wholly and exclusively for its stated purpose. **3.** The provisions of section 11(2) and 11(3) shall apply with few modification as specified in this section. **4.** Central Government may withdraw exemption in case of violation of conditions.
10(22B)	Any notified news agency	Any income	**1.** The news agency is set up solely for collection and distribution of news and applies its income or accumulation for collection or distribution of news as such. **2.** It does not distribute its income to its members in any manner. **3.** The government notification at any one time shall have effect, not exceeding three years. **4.** The government may after giving opportunity to agency, rescind such notification if it, finds that the agency does not adhere to the specified conditions.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(23A)	An association or institution set up in India for specified professions	Any income **other than** • Income from house property • Interest or dividend from investment • Income from rendering specific services to its members.	**1.** The association or institution shall be notified by the Central Government. **2.** The notified association or institution shall apply or accumulate its income for the purpose for which it is established. **3.** The Government may after giving opportunity to such institution, withdraw the approval if it finds that such association or institution does not adhere to the specified conditions.
10(23AA)	Any person on behalf of funds mentioned in third column	Any income	Income is received on behalf of Regimental Fund or Non Public Fund, established by armed force for welfare of, its member or his dependent.
10(23AAA)	Any person on behalf of funds mentioned in third column	Any income	1. Fund is established for notified purpose by Board for welfare of employees or their dependents. 2. The fund applies or accumulates its income exclusively for the purpose for which it is established. 3. The fund shall invest its income, contribution or other sum as specified u/s 11(5) of the Act. 4. The fund is approved as per Rule 16C by commissioner who may approve such fund for any period not exceeding three years.
10(23AAB)	Any fund setup by LIC or other insurer	Any income	1. The fund is set up after 1-8-1996 by LIC or other insurer for pension scheme to which contribution is made by any person to receive pension from such fund. 2. The fund is approved by Controller of insurance or other authority established under Insurance Regulatory and Development Authority Act, 1999.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(23B)	An institution constituted as Society or public charitable trust	Any income	1. The institution is established for Khadi and Village industries which are approved by Commissioner for not more than 3 years. 2. The institution shall apply or accumulate its income solely for development of Khadi and Village industries. 3. The Commissioner may after giving opportunity to such institution, withdraw the approval if he finds that such institution does not adhere to the specified conditions.
10(23BB)	Authority established under state or provincial Act for development of Khadi and village industries	Any income	-
10(23BBA)	Authority or body established or appointed under central, state or Provincial Acts	Any income	The authority is established to provide administration of public religious or charitable trusts, endowments (Temples, Maths, wakfs, synagogues etc.),societies for religious or charitable purpose formed under the applicable laws.
10(23BBB)	European Economic community	Interest, dividend, capital gains	The income is earned out of investments made under notified schemes by central government.
10(23BBC)	SAARC Fund for regional projects	Any income	The fund is set up by Colombo Declaration issued on 21-12-1991 for regional projects
10(23BBE)	Insurance regulatory and Development Authority	Any income	The authority is established under section 3(1) of Insurance Regulatory and Development Authority Act, 1999.
10(23BBG)	Central Electricity Regulatory Commission	Any income	The commission is constituted under section 76(1) of the Electricity Act, 2003
10(23BBH)	Prasar Bharati (Broadcasting corporation of India)	Any income	The said Prasar Bharati is established under section 3(1) of Prasar Bharati (Broadcasting corporation of India) Act, 1990.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(23C)	Income received by any person on behalf of following entities **(a)** Prime Minister's National Relief fund. **(b)** Prime Minister's fund for promotion of folk art **(c)** Prime Minister's Aid to Students Fund **(d)** National foundation for communal harmony **(e)** Swachh Bharat Kosh **(f)** Clean Ganga Fund **(g) Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund (inserted by Finance Act, 2017 w.r.e.f. A.Y. 1998-99)** **(h)** University or other Educational Institution wholly or substantially financed by the Government **(i)** Hospital or other institution wholly or substantially financed by Central govt. for treatment of specified illness and established for philanthropic purpose only. **(j)** University or educational institution set up for education purpose and not for profit and whose gross receipt does not exceed Rs.1 crore.	Any income	**1.** The fund, trust, university, hospitals, charitable organization requiring approvals shall make an application in prescribed form to prescribed authority for the grant of or continuation of exemption. **2.** Exemption shall not be available for anonymous donations referred to in section 115BBC. **3.** The provisions of section 11, 12 or 12AA shall also apply to various institutions referred to herein. **4.** The institutions where their income exceeds the maximum amount chargeable to tax shall get their accounts audited. **5.** With retrospective effect from A.Y. 09-10 In case of other charitable trusts, universities, hospitals, charitable organization approved by specified authority in which case 1st proviso to Sec.2(15) applies exemption under this sec. shall not be allowed. **6.** Where any income is required to be applied (or accumulated or set apart for application), then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation (or otherwise) in respect of any asset, acquisition of which has been claimed as an application of income under section 10(23) in the same or any other previous year.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(23C)	**(k)** Hospital or other institution set up for philanthropic purpose for treatment of specified illness and whose gross receipts do not exceed Rs. 1 crore. **(l)** Other charitable trusts, universities, hospitals, charitable organization approved by specified authority	Any income	• **For Entities mentioned at (g) and (h)** Any university or other educational institution, hospital or other institution referred therein, shall be considered as being substantially financed by the Government for any previous year, if the Government grant to such university or other educational institution, hospital or other institution exceeds such percentage of the total receipts including any voluntary contributions, as may be prescribed (50% prescribed), of such university or other educational institution, hospital or other institution, as the case may be, during the relevant previous year. • **For Entities mentioned at (k)** Entities which have been approved or notified for claiming benefit of exemption u/s 10(23) would not be entitled to claim any benefit of exemption under other provisions of section 10 (except the exemption in respect of agricultural income). **Refer Practical 12 and 13** • **For Entities mentioned at (l)** **With effect from Assessment Year 2018-19,** any donation (contribution) given to a trust or institution with a specific direction that they shall form part of the corpus of recipient trust or institution, then it shall not be treated as application of income for the donor trust or institution falling under point no. (l). **[Amendment by Finance Act, 2017]**
10(23D)	Specified Mutual funds	Any income	The mutual fund is either registered under SEBI or is set up by public sector Bank, public sector financial institution or such fund as approved by RBI and shall be subjected to such conditions as notified.
10(23EA)	Investor protection fund set up by recognized stock exchange	Any income by way of contribution received from recognized stock exchange or its member	**1.** The fund is set up by recognized stock exchanges either jointly or separately, as may be notified by Central Government. **2.** The amount which is standing to the credit of the fund and not subjected to tax under this provision, is shared with the recognized stock exchange, shall be chargeable to tax in the year in which it is shared.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(23EC)	Investor protection fund set up by commodity exchange	Any income by way of contribution received from commodity exchange or its member	**1.** The fund is set up by commodity exchanges either jointly or separately as may be notified by Central Government. **2.** The amount which is standing to the credit of the fund and not subjected to tax under this provision, is shared with the commodity exchange, shall be chargeable to tax in the year in which it is shared.
10(23ED)	Investor protection fund set up by depository	Any income by way of contribution received from a depository	**1.** The fund is set up by depository as notified Central Government. **2.** The amount which is standing to the credit and not subjected to tax under this provision is shared with the depository, shall be chargeable to tax in the year in which it is shared. **Refer Practical 14**
10(23EE)	Core Settlement Guarantee Fund of the Clearing Corporation	(1) Income by way of contribution received from specified persons. (2) The income by way of penalties imposed by the recognised clearing corporation and credited to the Core Settlement Guarantee Fund; (3) The income from investment made by the Fund	Where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with the specified person, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall, accordingly, be chargeable to income-tax. **Explanation:** For the purpose of this section "Specified person means **(a)** any recognised clearing corporation which establishes and maintains the Core Settlement Guarantee Fund; **(b)** any recognised stock exchange being a shareholder in such recognised clearing corporation or a contributor to the Core Settlement Guarantee Fund; and **(c)** any clearing member contributing to the Core Settlement Guarantee Fund;". **Refer Practical 15**

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(23FB)	Venture capital fund or venture capital company	Any income from investment in Venture Capital Undertaking This clause shall not apply in respect of any income of a venture capital company or venture capital fund, being an investment fund specified in clause (a) of the Explanation 1 to section 115UB,	"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; 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 **"venture capital fund" means** a fund— **(A)** operating under a trust deed registered under the provisions of the Registration Act, 1908, which— (I) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund; 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. "**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. Also refer Publication – Assessment of various entities – **Chapter 18: Taxation of Business Trusts**

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(24)	Registered union or Association of such unions	Income from house property or income from other sources	1. The union is registered under Trade union Act, 1926. 2. It is formed with the object of regulating relations between workmen and employers or between workmen and workmen.
10(25)	Provident fund to which Provident Fund Act, 1925 applies.	Interest on securities and Capital gains on sale of such securities	-
	• Recognized Provident fund • Approved superannuation fund • Approved gratuity fund • Coal Mines provident fund and miscellaneous provisions Act,1948 • Employees provident fund and miscellaneous provisions Act, 1952	Any income	
10(25A)	Employees state insurance fund	Any income	E S I C fund is set up under Employees State Insurance Act, 1948.
10(26)	Member of schedule Tribes residing in specified areas	(a) Income from any source in that area (b)Dividend and Interest on securities (source may be anywhere in the world)	Specified areas are:- State of Nagaland, Manipur, Tripura, Arunachal Pradesh, Mizoram or certain districts of Assam or in the Ladakh region of the state of J&K.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(26AAA)	A Sikkimese individual	**(a)** Income from any source in the State of Sikkim **(b)** Dividend and Interest on securities (source may be anywhere in the world)	The income of Sikkimese woman marrying to non-Sikkimese persons after 1-4-2008 shall not be entitled to exemption under this clause. **Refer Practical 16 and 17**
10(26AAB)	Agricultural produce market committee or Board	Any income	The APMC or board is constituted under any law for the purpose of regulating marketing of agricultural produce.
10(26B)	Government corporation or any association, body, institution wholly financed by government	Any income	The corporation is established by a central state or provincial Act or any association, body, institution wholly financed by the government and is formed with the object to promote interest of schedule caste, schedule Tribe or backward classes.
10(26BB)	Government corporation formed by state or central government	Any income	Such corporation is established to promote the interest of the notified minority community.
10(26BBB)	corporation formed by state or central or provincial Act	Any income	Such corporation is formed for the welfare and upliftment of ex-servicemen being citizens of India and served for armed force of union or Indian state before the commencement of constitution of India.
10(27)	A co-operative society	Any income	1. Such co-operative societies are formed for promoting interest of schedule caste or schedule tribes. 2. Members of such societies shall consist only of other societies formed for similar purpose and 3. Funds of the society is provided by the government or such other society.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(29A)	• Tea Board • Coffee Board • Rubber Board • Tobacco Board • Spices Board • Coir Board • Marine Products • Export Development Authority • Agricultural & Processed Food Product Export Authority	Any income	-
10(30)	Any assessee engaged in growing and manufacturing Tea in India	Subsidy received from Tea Board.	1. Subsidy is received for re-plantation or replacement of tea bushes or for rejuvenation or consolidation of area used for cultivation of tea under scheme notified by government. 2. The assessee shall furnish certificate of subsidy so received to the income tax officer along with return of income
10(31)	Any assessee carrying on business of growing and manufacturing rubber, coffee, cardamom or other commodities notified by central Govt.	Subsidy received from concerned Board	1. Subsidy is received for re-plantation or replacement of respective commodity bushes or for rejuvenation or consolidation of area used for cultivation of such commodity under scheme notified by government. 2. The assessee shall furnish certificate of subsidy so received to the income tax officer along with return of income.
10(32)	An assessee referred to in section 64(1A)	Income included u/s 64(1A)	Any income of minor child other than specially exempt are included in the income of the parent and any such income included in the hands of the parent shall be excluded to the extent of Rs. 1500/- for each child.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(34)	Any assessee	Dividend	Dividend exempt under this provision is as referred to in section 115-O. However, benefit of exemption is not available to dividend income referred to in section 115BBDA. **Refer Para 2.6**
10(34A)	Any assessee being a shareholder of a company	Amount received on buy back of shares of unlisted company	The company buying back the shares is the one which is referred to in Section 115QA.
10(35)	Any assessee	Income received in respect of Units of specified mutual fund, specified undertaking, specified Company, other than on transfer of such units.	Income on transfer of such units (i.e. capital gain) are not exempt under this provision.
10(39)	Notified persons	Specified income out of international sporting events	Such international sporting event **1.** is approved by the international body regulating the international sport relating to such event; **2.** has participation by more than two countries; **3.** is notified by the Central Government in the Official Gazette for the purposes of this clause. ***Explanation.—*** For the purposes of this clause, "the specified income" means the income, of the nature and to the extent, arising from the international sporting event, which the Central Government may notify in this behalf;

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(40)	Subsidiary company	Any income of any subsidiary company by way of grant or otherwise received from an Indian holding company	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: **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.
10(42)	Notified body or authority	Specified income	1. Body or Authority is constituted not for profit under a treaty or agreement signed by central government with two or more countries or convention. 2. The authority or body shall be notified by the Central government
10(43)	An individual	Amount received as loan	The loan received either in lump sum or in installments should be in transaction of reverse mortgage as referred to in section 47(xvi)
10(44)	New pension system trust	Any income received for and on behalf of such trust	---
10(45)	Chairman or member (including retired one) of union public service commission	Notified allowance or perquisites	Any notified allowance or perquisites paid to such persons (w.e.f. from 1-4-2008). **Refer Practical 18**

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(46)	Any body, authority, Board or Trust or Commission (e.g. NSDC, CCI have been notified for this section)	Specified income	(1) Such body, authority etc., should be formed under Central, State or Provincial Act or by the central or state government. (2) Such body should be established for regulating or administrating activities for benefit of general public. (3) The nature and the extent of income exempt, shall be specified by the Central Government
10(47)	Infrastructure debt fund	Any income	1. The fund is set up as per prescribed guidelines 2. The notification is issued by the government in this regard.
10(48)	Foreign Company	Income received on account of sale of crude oil, any other goods or rendering of services as may be notified by Central Government in this behalf	(i) Recipient of income is a foreign company. (ii) Income is received in India in Indian currency. (iii) Receipt of such income in India by the foreign company is pursuant to an agreement/arrangement entered into by the Central Government or approved by the Central Government. (iv) The foreign company and the agreement/arrangement are notified by the Central Government in this behalf.**[Name of Notified company is:- National Iranian Oil Company]**
10(48A)	Foreign Company	Any income accruing or arising on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India.	1. Storage and sale by the foreign company in pursuant to an agreement or arrangement entered into by the Central Government or approved by the Central Government. 2. Further, such agreement and foreign company is notified by the Central Government.

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(48B)	Foreign Company **(Inserted by Finance Act, 2017 w.e.f. A.Y. 2018-19)**	Any income accruing or arising on account of sale of leftover stock of crude oil from the facility in India after the expiry of agreement u/s 10(48A).	This exemption is subject to such conditions as Central Government may notify in this behalf.
10(50)	Any person	Any income arising from specified services provided and chargeable to equalization levy.	Such specified services shall be chargeable to equlisation levy under chapter VIII of the Finance Act, 2016.

2.2 SPECIAL PROVISIONS IN RESPECT OF NEWLY ESTABLISHED UNITS IN SPECIAL ECONOMIC ZONES

Section:- 10AA

(A) Conditions:

(1) A unit in SEZ has begun to manufacture or produce any article or things or provide any services after 31.03.2005 but on or before 31st March, 2020.

(2) The unit in SEZ is not formed by the splitting up, or the reconstruction, of a business already in existence.

However, where an industrial undertaking is formed as a result of re-establishment, reconstruction or revival by the assesse of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section the same will quality for the tax concession.

Section 33B

The business of any industrial undertaking carried on in India is discontinued in any previous year by reason of extensive damage to, or destruction of, any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business as a direct result of—

(*i*) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature ; or

(*ii*) riot or civil disturbance ; or

(*iii*) accidental fire or explosion ; or

(*iv*) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),

and, thereafter, at any time before the expiry of three years from the end of such previous year, the business is re-established, reconstructed or revived by the assessee.

(3) The unit in SEZ is not set up by the transfer of plant and machinery previously used for any purpose. This condition is subject to following relaxation:

(a) *20 per cent previously used plant and machinery is permitted* - If the value of the previously used plant and machinery does not exceed 20 per cent of the total value of the machinery or plant used in the business, this condition is deemed to have been complied with.

(b) *Second-hand imported machinery is treated as new-* 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 the following conditions are fulfilled—

(i) Such machinery or plant was not, at any time previous 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.

(iii) No deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the 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.

(4) The assessee shall furnish the report from an chartered accountant in a prescribed form along with the return of income, certifying that the deduction has been correctly claimed in accordance with the provision of this section.

(5) Deduction under section 10AA is not available unless it is claimed in the return of income. – Section 80A(5).

(6) *If deduction is claimed in respect of a specified business [as referred to in section 35AD(8)(c)] under section 10AA, no deduction in respect of that business will be available under section 35AD.*

(B) Period and quantum of deduction:-

First 5 consecutive assessment years (beginning with the assessment year in which undertaking begins to manufacture or produce articles or things or computer software, as the case may be)	100% of profits and gains derived from export
Next 5 assessment years	50% of profits and gains derived from export
Next 5 assessment years	50% of profits and gains derived from export or amount transferred to "Special Economic Zone Reinvestment Allowance Reserve Account" whichever is lower.

(C) The above created reserve shall be utilized for the purpose of acquiring new plant and machinery in the following manner:-

(1) The new Plant and Machinery shall be first put to use before the expiry of 3 years from the end of year in which the reserve was created.

(2) Until the acquisition of new Plant & Machinery, the reserve may be utilized for the business purposes of the unit. However, it cannot be utilized for the distribution of dividends or profits or for remittance outside India as profits or for creating any asset outside India.

(3) Prescribed particulars shall be submitted in respect of new plant and machinery along with the return of income for the previous year in which such plant and machinery was first put to use.

(4) If the reserve is misutilized then the deduction shall be taken back in the year in which the reserve is misutilized and chargeable to tax in that year.

(5) If the reserve is not utilized for acquiring new plant and machinery within three years as stated above then the deduction shall be taken bank in the year immediately following the period of three years.

(D) Profits and gains derived from export shall be worked out as under:-

Profits of the business of the unit $\times \frac{\text{Export turnover of the unit}}{\text{Total Turnover of the unit}}$

- Export Turnover means the consideration in respect of export by the unit of articles or things or services received in, or brought into India by the assessee, <u>but does not include the following</u>:
  a. Freight;
  b. Telecommunication charges;
  c. Insurance attributable to the delivery of the articles or things outside India;
  d. Expenses, if any, incurred in foreign exchange in rendering of services outside India.
- The profits and gains derived from on-site development of computer software including services for development of software outside India shall be deemed to be export profits eligible for deduction.

(E) Ceiling on deduction to be claimed under section 10AA of the Act

As per the amendment made by Finance Act, 2017 w.e.f. A.Y. 2018-19,

(a) Amount of deduction under section 10AA shall be allowed from the total income of the assessee computed under the Act before giving deduction under section 10AA and

(b) Deduction under section 10AA shall not exceed (a) above.

(F) Power of A.O. to re-compute Profit

The provisions of 80IA(8) and 80IA(10) shall apply mutatis mutandis to the unit of SEZ claiming benefit under this section.

(G) Impact once benefit has been availed under section 10AA

- During the period of deduction, depreciation is deemed to have been allowed on the assets. Written down value shall be accordingly reduced.
- No deduction u/s.80 IA or 80-IB shall be allowed in relation to the profits and gains of unit of SEZ.
- Any unabsorbed depreciation u/s.32(2); or business loss u/s.72 (1) or loss under the head 'Capital gains' u/s.74 of the unit shall not be allowed to be carried forward and set off where such loss relates to any of the assessment years ending before the 1st day of April, 2006

(H) Impact when amalgamation or demerger takes place:-

Where an undertaking is transferred to another company under a scheme of amalgamation or demerger, the deduction under this section shall be allowable in the hands of the amalgamated or the resulting company for the unexpired period.

However, no deduction shall be admissible under this section to the amalgamating company or demerged company for the previous year in which amalgamation or demerger takes place.

Practical 1

Rajesh Exports Pvt Ltd. has set up its manufacturing unit in SEZ which is eligible for the benefit under section 10AA of Income Tax Act. Apart from that it has another manufacturing unit in Non-SEZ area. It provides following information for the year under consideration:

Particulars	(Rs. In lakhs)
Profit from the manufacturing unit set up in SEZ (Export turnover/Total Turnover = 90%)	80
Profit from the manufacturing unit in Non-SEZ area	-40
Income from other sources	22
Amount eligible for deduction under section 80G	5

Compute total income of Rajesh Exports Pvt Ltd. (a) before amendment made by Finance Act, 2017 (b) After amendment made by Finance Act, 2017.

Solution

(a) Computation of Total Income of Rajesh Export Pvt Ltd. before amendment

Particulars	Rs.	Rs.
Profit from the manufacturing unit set up in SEZ	80	
Less: Exemption under section 10AA (90% of Rs. 80)	(72)	8
Profit from the manufacturing unit in Non-SEZ Area		(40)
Income under the head PGBP (A)		**(32)**
Income from Other sources (B)		**22**
Gross Total Income (A) plus (B)		**(10)**
Deduction under section 80 G		Nil
Total Income		**(10)**

Note: Business loss to be carried forward Rs. 10 Lakh.

(b) Computation of Total Income of Rajesh Export Pvt Ltd. after amendment

Particulars	Rs.	Rs.
Profit from the manufacturing unit set up in SEZ	80	
Profit from the manufacturing unit in Non-SEZ Area	(40)	
Income under the head PGBP (A)		**40**
Income from Other sources (B)		**22**
Gross Total Income (A) plus (B)		**62**
Less: Deduction under section 80 G		(5)
Total Income before giving deduction under section 10AA (C)		**57**
Less: Deduction under 10 AA is lower of followings:		(57)
(a) Total income as per (C) above	57	
(b) Deduction under section 10AA (90% of Rs. 80)	72	
Total Income		**Nil**

Readers Note:

Practical 2

Siddarth Ltd. has an undertaking (Unit-X) in Special Economic Zone (SEZ) and another undertaking (Unit- Y) in Free Trade Zone (FTZ) for manufacturing of computer software. It furnishes the following particulars for its 2nd year of operations ended on **31st March, 2018**:

Particulars	Unit X (Rs. In lakhs)	Unit Y (Rs. In lakhs)
Total Sales:	180	120
Export Sales : (Inclusive of Rs. 10 lacs for onsite development of computer software outside India by Unit X)	120	10
Profit earned[After claim of bad debts under section 36(1)(vii) in Unit X]	63	36

Plant and machinery used in the business has been depreciated at 15% on straight line method (SLM) basis and depreciation of Rs. 9 lacs was charged to profit and loss account in the proportion of sales during the previous year.

Rs. 100 lacs were realized out of export sales in time and balance of Rs. 20 lacs becomes irrecoverable due to bankruptcy of one of the foreign buyers in Unit-X. Compute the deduction under section 10AA of the Income-tax Act, 1961 and taxable income of Siddarth Ltd. for the Assessment Year **2018-19.**

Solution

Computation of total income of Siddarth Ltd. for A.Y.2018-19

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Unit X (See Note 4)	63,81,000	
Less: Deduction under section 10AA (See Working below)	(35,45,000)	28,36000
Unit Y (See Note 4)		36,54,000
Total Income		**64,90,000**

Working Note:

Deduction under section 10AA in respect of Unit X (See Notes 1, 2 & 3)

= Profits of Unit X × $\frac{Export\ turnover\ of\ the\ Unit\ X}{Total\ turnover\ of\ Unit\ X}$

= Rs. 63,81,000 × $\frac{Rs.1,00,00,000}{Rs.1,80,00,000}$

= Rs. 35,45,000

Notes:

(1) It is assumed that Unit X has fulfilled all the specified conditions for claiming deduction under section 10AA of the Act. Unit Y is, however, not eligible for deduction under section 10AA in respect of the exports made by it since it is located in a Free Trade Zone.

(2) Export turnover, for the purpose of section 10AA, means the consideration received in respect of export by the unit in SEZ. Therefore, in this case, the amount of Rs. 20,00,000 which has become irrecoverable due to bankruptcy of one of the foreign buyers in Unit X will not be included in its export turnover. Therefore, export turnover of Unit X (in SEZ) = Rs. 1,20,00,000 – Rs. 20,00,000 = Rs. 1,00,00,000.

(3) Profits and gains from on site development of computer software outside India shall be deemed to be the profits and gains derived from export of computer software outside India. Since the same has already been included in the figure of export sales, no further adjustment is required.

(4) Computation of unit-wise profits of the business

Particulars	Unit X (Rs.)	Unit Y (Rs.)
Profit earned [after claim of bad debts u/s 36(1)(vii) in Unit X]	63,00,000	36,00,000
Add: Depreciation calculated on SLM basis and charged in the proportion of sales (3:2)	5,40,000	3,60,000
Sub-total	**68,40,000**	**39,60,000**
Less: Depreciation calculated @15% on WDV basis and charged in the proportion of sales (3:2) (See Note 5)	(4,59,000)	(3,06,000)
Profits of the business	**63,81,000**	**36,54,000**

(5) Depreciation as per the Income-tax Rules, 1962 for the A.Y.2018-19 has to be calculated as follows–

Particulars	Unit X (Rs.)
Actual cost of plant and machinery (Rs. 9,00,000 / 15%)	60,00,000
Less: Depreciation @15% for P.Y.2016-17 (being the first year of operations). It is logical to assume that the assets were put to use for more than 180 days during the year.	9,00,000
Written down value as on 1.4.2017	51,00,000
Depreciation @15% on WDV for P.Y.2017-18 (Rs. 51,00,000 × 15%)	**7,65,000**

Readers Note:

Practical 3

ABC Informatics Private Limited is engaged in the development of software, already operates one IT unit in "SEZ Sargasan, Gujarat". It further set up new unit in "SEZ Koba, Gujarat" in the financial year 2016-17 by purchasing the space and installing new computers amounting to Rs. 3.50 crores. Apart from hiring new 50 employees for IT unit at "SEZ Koba, Gujarat", 30 employees of IT unit at "SEZ Sargasan, Gujarat" were transferred permanently to work for new unit at "SEZ Koba, Gujarat".

ABC informatics Private Limited claimed benefit of section 10AA for IT unit at "SEZ Koba, Gujarat". However, the assessing officer denied the benefit on the ground that these new unit is started with the help of re-deployment of existing technical manpower and therefore it amounts splitting up or reconstruction of existing business.

ABC Informatics Private Limited seeks your opinion and professional advice in the matter.

Solution

The CBDT had earlier clarified vide Circular No.12/2014 dated 18th July, 2014 that mere transfer or re-deployment of existing technical manpower from an existing unit to a new SEZ unit in the first year of commencement of business will not be construed as splitting up or reconstruction of an existing business, provided the number of technical manpower so transferred does not exceed 20% of the total technical manpower actually engaged in developing software at any point of time in the given year in the new unit.

The limit of 20% was considered inadequate and restrictive and it impacted the competitiveness of Indian Software Industry in global market. Consequently, the matter was re-examined by the CBDT, and in supersession of Circular No.12/2014 dated 18th July, 2014, it has now been decided that the transfer or re-deployment of technical manpower from existing unit to a new unit located in SEZ, in the first year of commencement of business, **shall not be construed as splitting up or reconstruction of an existing business, provided the number of technical manpower so transferred as at the end of the financial year should not exceed 50% of the total technical manpower actually engaged in development of software or IT enabled products in the new unit.**

Alternatively, if the assessee-enterprise is able to demonstrate that the net addition of the new technical manpower in all units of the assessee-enterprise is at least equal to the number that represents 50% of the total technical manpower of the new SEZ unit during such previous year, deduction under section 10AA would not be denied provided the other prescribed conditions are also satisfied. The assessee-enterprise will have the choice of complying with any one of the two alternatives given above to avail the benefit of deduction under section 10AA.

The Circular also clarifies that:

(a) it shall be applicable only in the case of assessees engaged in the development of software or in providing IT enabled services in SEZ units eligible for deduction under section 10AA.

(b) it shall not apply to the assessments which have already been completed. Further, no appeal shall be filed by the Department in cases where the issue is decided by an appellate authority in consonance with this circular.

In the present case study, the number of technical manpower transferred from Sargasan Unit to Koba Unit is not exceeding 50% of total manpower of Koba Unit (It is 30 / 80 = 37.5%).

Therefore, denial of exemption under section 10AA by the assessing officer is not in accordance with the clarification given in present circular of CBDT.

Readers Note:

Circular No. 1/2013, dated 17.01.2013

Clarification on issues relating to export of computer software for the purpose of section 10AA

Sr. No.	Issue	Clarification given by the CBDT
(1)	Would "On-site" development of computer software qualify as an export activity for tax benefit u/s 10AA?	The software developed abroad at a client's place would be eligible for such benefit, because these would amount to 'deemed export'.
(2)	Would receipts from deputation of technical manpower for such "On-site" software development abroad at the client's place be eligible for deduction u/s 10AA?	Explanation 2 to section 10AA clarifies that profits and gains derived from 'services for development of software' outside India would also be deemed as profits derived from export. Therefore, profits earned as a result of deployment of technical manpower at the client's place abroad specifically for software development work pursuant to a contract between the client and the eligible unit should not

		be denied benefit under section 10AA provided such deputation of manpower is for the development of such software and all the prescribed conditions are fulfilled.
(3)	Is it necessary to have separate master service agreement (MSA) for each work contract?	It is clarified that the tax benefits under section 10AA would not be denied merely on the ground that a separate and specific MSA does not exist for each SOW (Statement of Works). The SOW would normally prevail over the MSA in determining the eligibility for tax benefits unless the Assessing Officer is able to establish that there has been splitting up or reconstruction of an existing business or non-fulfillment of any other prescribed condition.
(4)	Would tax benefit under section 10AA continue to be available in case of a slump sale of a unit?	The answer to this issue would depend on the facts of each case, such as how a slump-sale is made and what is its nature. It will also be important to ensure that the slump sale would not result into any splitting or reconstruction of existing business. It is, however, clarified that on the sole ground of change in ownership of an undertaking, the claim of exemption cannot be denied to an otherwise eligible undertaking and the tax holiday can be availed of for the unexpired period at the rates as applicable for the remaining years, subject to fulfillment of prescribed conditions
(5)	Can tax benefits under section 10AA be enjoyed by an eligible SEZ unit consequent to its transfer to another SEZ?	It is clarified that the tax holiday should not be denied merely on the ground of physical relocation of an eligible SEZ unit from one SEZ to another in accordance with Instruction No. 59 of Department of Commerce, if all the prescribed conditions are satisfied under the Income-tax Act, 1961. It is further clarified that the unit so relocated will be eligible to avail of the tax benefit for the unexpired period at the rates applicable to such years.
(6)	Whether new units set up in the same location where there is an existing eligible unit would amount to expansion of the existing unit?	This issue is a matter of fact requiring examination and verification. However, it has been clarified that setting up of such a fresh unit in itself would not make the unit ineligible for tax benefits, provided – (i) the unit is set-up after obtaining necessary approvals from the competent authorities; (ii) it has not been formed by splitting or reconstruction of an existing business; and (iii) it fulfils all other conditions prescribed u/s 10AA

2.3 INCOME OF POLITICAL PARTY

Section:- 13A

(1) Political party means an AOP or BOI citizens of India registered or deemed to be registered with the Election Commission of India as a political party

(2) Following categories of income are not included in computing total income:

(a) Income under the head "House Propery", "Capital Gain" and "Other sources" are exempt from tax

(b) Any income by way of voluntary contribution

(3) Conditions for availing the exemption:

(a) The political party keeps and maintains such books of account and other documents as would enable the A.O. to properly deduce its income therefrom

(b) The political party keeps and maintains a record of each voluntary contribution (except contribution by way of electoral bond) in excess of Rs. 20,000/- and of the names and addresses of persons who have made such contirbutions

(c) The accounts of the political pary are audited by a chartered accountant or other qualified accountants.

(d) The treasurer of a political party shall in each financial year prepare a report in respect of contribution received by the political pary in excess of Rs. 20,000/- from any person / company in that year and submit it (before due date of submission of return of income) to the Election Commission.

(e) no donation exceeding Rs. 2,000 is received by such political party otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through electoral bond. (**inserted by Finance Act, 2017 w.e.f. A.Y. 2018—19)**

(f) It shall furnish the return of income in accordance with the provisions of section 139(4B) on or before the due date u/s 139(1) of the Act. (**inserted by Finance Act, 2017 w.e.f. A.Y. 2018—19)**

2.4 EXEMPTION TO ELECTORAL TRUST

Section:- 13B

With effect from 1-4-2010, a new section 13B has been inserted which provides for exemption to income by way of voluntary contributions received by electoral trust if it satisfies all the following conditions:

(1) Distributes ninety-five per cent of the aggregate voluntary contributions received by it during the previous year along with the surplus brought forward from any earlier previous year to any political party registered under section 29A of the Representation of the People Act, 1951;

(2) Functions in accordance with the rules made by the Central Government. [Relevant Rule is Rule 17CA]

Analysis : It is imperative to note here that exemption is given to the electoral trust- only for the income by way of voluntary contributions and not for the other incomes.

2.5 RESTRICTIONS ON ALLOWABILITY OF EXPENDITURE

Section:- 14A and Rule 8D

Secttion 14A(1): As per section 14A, expenditure incurred in relation to any exempt income is not allowed as a deduction wh ile computing income under any of the five heads of income.

However, the Assessing Officer is not empowered to reassess under section 147 or to pass an order increasing the liability of the assessee by way of enhancing the assessment or reducing a refund already made or otherwise increase the liability of the assessee under section 154, for any assessment year beginning on or before 1.4.2001 i.e. for any assessment year prior to A.Y. 2002-03.

Section 14A(2): The Assessing Officer is empowered to determine the amount of expenditure incurred in relation to such income which does not form part of total income in accordance with such method as may be prescribed.

The method for determining expenditure in relation to exempt income is to be prescribed by the CBDT for the purpose of disallowance of such expenditure under section 14A. Such method should be adopted by the Assessing Officer if he is not satisfied with the correctness of the claim of the assessee, having regard to the accounts of the assessee.

Section 14A(3): Further, the Assessing Officer is empowered to adopt such method, where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income.

Rule 8D

Rule 8D lays down the method for determining amount of expenditure in relation to income not includible in total income. If the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with –

(a) the correctness of the claim of expenditure by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred in relation to exempt income for such previous year,

he shall determine the amount of expenditure in relation to such income in the manner provided hereunder -

The expenditure in relation to income not forming part of total income shall be the aggregate of the following:

(i) the amount of expenditure directly relating to income which does not form part of total income;

(ii) an amount equal to 1% of the opening and closing balance of the annual average of the monthly average of the value of investment, income from which does not form part of total income. However, such amount cannot exceed the total expenditure claimed by the assessee.

Clarification regarding disallowance of expenses under section 14A in cases where corresponding exempt income has not been earned during the financial year [Circular No. 5/2014, dated 11.2.2014]

Section 14A provides that no deduction shall be allowed in respect of expenditure incurred relating to income which does not form part of total income. A controversy has arisen as to whether disallowance can be made by invoking section 14A even in those cases where no income has been earned by an assessee, which has been claimed as exempt during the financial year.

The CBDT has, through this Circular, clarified that the legislative intent is to allow only that expenditure which is relatable to earning of income. Therefore, it follows that the expenses which are relatable to earning of exempt income have to be considered for disallowance, irrespective of the fact whether such income has been earned during the financial year or not.

Practical 4

Mr. W has provided the following information regarding his income and expenditure of the previous year **2017-18.**

Particulars	Rs.
Income from business (computed)	5,00,000
Dividend income from Money Market Mutual Funds	1,25,000
Consultancy charges to Mutual Fund agent	15,000
Interest expenditure relating to both taxable and non-taxable income	2,25,000

Annual average of the monthly average of the opening and closing balances of the value of investments in mutual fund is Rs. 50,00,000.

Value of total assets as appearing in Balance Sheet as on first day and last day of the previous year are Rs. 50,00,000 and Rs. 70,00,000.

Mr. W claims that no expenditure was incurred by him for exempt income earned. The Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to exempt income. You are required to compute the amount of expenditure incurred in relation to exempt income and resultant total income, assuming that Mr. W has no other income.

Solution

As per section 14A, expenditure incurred in relation to any exempt income is not allowed as deduction. However, if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to exempt income, or the claim made by the assessee that no expenditure has been incurred in relation to exempt income for such previous year, he shall determine the amount of expenditure in relation to such income in the manner provided in Rule 8D.

In this case, Mr. is in receipt of dividend income which represents exempt income and further he claims that no expenditure is incurred for the purpose of earning this income, the assessing officer is empowered to invoke Rule 8D. The computation as per Rule 8D is given as under:

Particulars	Rs.
(i) The amount of expenditure directly relating to exempt income	
• Consultancy charges paid to Mutual Fund Agent	15,000
(ii) 1% of the annual average of the monthly average of the opening and closing balances of the value of investment in Mutual Fund Units 1% of 50,00,000	50,000
[The amount in (i) & (ii) put together should not exceed the total expenditure claimed by the assessee]	
Amount of expenditure in relation to exempt income	**65,000**

Computation of total income of Mr. W for the A.Y. 2018-19

Particulars	Rs.
Income from business (computed)	5,00,000
Add: Amount of expenditure in relation to exempt income	65,000
Income from business / Total Income	**5,65,000**

Readers Note:

Practical 5

Can the provisions of section 14A of the Income-tax Act, 1961 be applied for disallowing expenditure relating to income for which deduction is available under Chapter VI-A, or the section can be invoked only in respect of expenditure relating to income exempt under the provisions of section 10?

Solution

Chapter III, comprising sections 10 to 13B, deals with incomes which do not form part of total income. As per section 14A(1), for the purposes of computing the total income under Chapter IV, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income-tax Act, 1961.

Thus, on a plain reading of section 14A, the intention is to disallow expenditure in relation to income which does not form part of total income i.e., expenditure in relation to income exempt u/s 10 to 13B. Therefore, the provisions of section 14A cannot be invoked for disallowing expenditure relating to income for which deduction is available under Chapter VIA.

This view is expressed by Delhi High Court in case of CIT vs. Kribhco (2012) 349 ITR 0618 (Delhi)

Readers Note:

2.6 EXEMPTION UNDER SECTION 10(34) NOT TO APPLY TO DIVIDEND CHARGEABLE TO TAX IN ACCORDANCE WITH SECTION 115BBDA

Section:- 115BBDA and 10(34) - Effective from A.Y. 2017-18 further Amended by FA 2017

- Section 115BBDA provides that any income by way of aggregate dividend in excess of Rs. 10 lakh shall be chargeable to tax in the case of a specified assessee who is resident in India, at the flat rate of 10%. Further, basic exemption limit of Rs.2,50,000 /Rs.3,00,000 / Rs.5,00,000 shall not be available for such dividend income.
- Further, no deduction in respect of any expenditure or allowance or set-off of loss shall be allowed to the assessee in computing the income by way of such dividends.
- Dividend for the purpose of this section means every dividend as covered by section 2(22) except section 2(22)(e).
- For the purpose of this section, specified assessee means any person other than-
  (a) Domestic company
  (b) Fund or institution or trust or university or medical institution referred to in section 10(23C)(iv)/(v)/(vi)/(via)
  (c) Trust or institution registered under section 12A or section 12AA
- Further, a proviso has been inserted to section 10(34) to provide that dividend income which is subject to section 115BBDA shall not be exempt in the hands of shareholder.

Practical 6

Find out tax liability of Mr. X and Mr. Y for the **assessment year 2018-19.**

Particulars	Mr. X (Rs.)	Mr. Y (Rs.)
Income under head PGBP	(15,00,000)	(9,00,000)
Dividend from Indian Companies on which CDT has been paid	18,00,000	7,30,000
Dividend under section 2(22)(e)	3,00,000	3,00,000

Solution

Points to be considered while computing total income and tax liability of Mr. X

Considering the provisions of section 115BBDA, Mr. X is subject to this section since dividend from Indian companies on which CDT has been paid exceeded Rs. 10,00,000. (Readers must remember that for the purpose of section 115BBDA, dividend under section 2(22)(e) shall not be taken into consideration). As a result, taxable dividend under section 115BBDA shall be Rs. 8,00,000. Such dividend shall be taxed at the flat rate of 10% without being set off of any loss.

However, dividend u/s 2(22)(e) shall be charged to tax u/s 56 of the Act in the hands of shareholder. Since, such dividend is not subject to section 115BBDA, therefore, set off is available against such dividend income.

Considering the above remarks, **Total Income of Mr. X** is computed as under:

Particulars	Rs. In lakhs
Income under head PGBP	(15,00,000)
Dividend from Indian Companies on which CDT has been paid	8,00,000
Dividend under section 2(22)(e)	3,00,000
Total Income	**8,00,000**

Computation of Tax liability of Mr. X

Tax on Rs.8,00,000 @ 10.30% (including education cess) = Rs. 82,400

Points to be considered while computing total income and tax liability of Mr. Y

Mr. Y is not subject to section 115BBDA since dividend from Indian companies on which CDT has been paid (Rs.7,30,000 in present case) did not exceed Rs. 10,00,000. (Readers must remember that for the purpose of section 115BBDA, dividend under section 2(22)(e) shall not be taken into consideration). Hence entire dividend income of Rs. 7,30,000 is exempt under section 10(34) in the hands of Mr. Y.

However, dividend u/s 2(22)(e) shall be charged to tax u/s 56 of the Act in the hands of shareholder. Since, such dividend is not subject to section 115BBDA, therefore, set off is available against such dividend income.

Considering the above remarks, **Total Income of Mr. Y** is computed as under:

Particulars	Rs.
Income under head PGBP	(9,00,000)
Dividend from Indian Companies on which CDT has been paid	Exempt under section 10(34)
Dividend under section 2(22)(e)	3,00,000
Total Income	**(6,00,000)**

Note: Loss under the head "PGBP" Rs.6,00,000 (Rs.9,00,000–Rs. 3,00,000) shall be c/f for next 8 A.Ys.

Computation of Tax liability of Mr. Y

Since total income is negative, tax payable is NIL.

Readers Note:

2.7 PRACTICALS COVERING VARIOUS EXEMPTION

Practical 7

An amount of Rs. 5 lacs was paid on 17.3.**2018** to the parents of Amit by the Government of Jharkhand as compensation to the aggrieved family, whose only son Amit lost his life in Maoist local bus bomb blast in Dantewada.

Explain with reasons, whether the amount of compensation received is chargeable to tax in A.Y.18-19?

Solution

As per section 10(10BC), the meaning of "disaster" shall be derived from Disaster Management Act, 2005 which defines disaster to mean a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man-made causes, or by accident or negligence.

Disaster must have the effect of causing substantial loss of life or human suffering or damage to, and destruction of property, or damage to, or degradation of environment and it shall be of such a nature or magnitude to be beyond the coping capacity of the community of the affected area.

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

Readers Note:

Practical 8

Latest Infrastructure Limited (LIL) took a keyman insurance policy on the life of its managing director for a term of 10 years. The LIL paid premium for the first 8 years and claimed deduction under section 37(1) of the Act. In the beginning of 9th year, LIL assigned the policy in favour of the managing director by recovering the surrender value. After assignment, managing director paid the last two instalment of insurance premium. On maturity, managing director received huge amount. The contention of the managing director is that entire amount received from insurance company is exempt under section 10(10D) on the ground that the policy is not a keyman insurance policy. The argument is that in order to be called "keyman insurance policy", it must be a policy taken by one person on the life of another person connected with business of first person. But in his case, after assignment of policy, it becomes a personal policy and it is not now a policy taken by the one person on the life of another person.

Is contention made by managing director tenable?

Solution

For the purposes of section 10(10D), "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration.

Considering the above definition, policy continues to be a keyman insurance policy even after assignment. Therefore, the contention raised by managing director is not tenable. Proceeds received on keyman insurance policy is subject to income tax and it cannot be exempt under section 10(10D).

Readers Note:

Practical 9

Both, Mr. Suresh (employee) and Mr. Mahesh (self-employed) annually contribute Rs. 1,50,000 to New Pension System (NPS) since 2011 and claimed deduction under section 80CCD. Both opted out of the NPS in the previous year **2017-18** and received Rs. 11,00,000. Discuss taxability, if any.

Does your answer differ if amount would have been received by the nominee, on the death?

Solution

Particulars	Mr. Suresh (employee)	Mr. Mahesh (self-employed)
Amount received from NPS is deemed to be the income for the previous year 2017-18 under section 80CCD (3)	Rs. 11,00,000	Rs.11,00,000
Less: Exemption under section 10(12A)	Rs. 4,40,000	N.A.
Taxable amount	Rs.6,60,000	Rs.11,00,000

If above amount would have been received by nominee on death, then as per proviso to 80CCD(3), nothing shall be taxed in the hands of nominee.

Readers Note:

Practical 10

Mr. Suresh, an employee of ECO POWER LTD contributed Rs.6,00,000 to New Pension System (NPS) since 2011 and claimed deduction under section 80CCD. Mr. Suresh was in need of money and therefore, planning to make partial withdrawal of Rs. 2,00,000 from the contribution made by him. Discuss taxability if any.

What would have been your answer if he decided to opt out of NIPS and received Rs. 11,00,000.

Solution

Particulars	Partial Withdrawal(Rs.)	Opting out of NPS (Rs.)
Amount received from NPS is deemed to be the income for the P.Y 2017-18 u/s 80CCD(3)	2,00,000	11,00,000
Less: Exemption under section 10(12A)	NA	(4,40,000)
Less: Exemption under section 10(12B)	(1,25,000)	NA
Taxable amount	75,000	Rs.6,60,000

Readers Note:

Practical 11

Amit, a captain in Indian army, was killed at Kashmir border during a war. The widow of Amit was paid an ex-gratia payment of Rs.5,00,000 in **March, 2018,** besides the family pension during the year of Rs. 2,40,000. She wants to know the taxability of both the receipts. Decide.

Solution

CBDT in its Circular No.776 of June 8, 1999 clarified that any lump sum ex-gratia payment made by the Central Government / State Government/Local Authority or Government, public sector undertaking, to the widow or other legal heirs of an employee, who dies while in active service, will not be taxable as income under the Income-tax Act, 1961. Therefore, Rs. 5,00,000 is not taxable.

Section 10(19) grants tax exemption in respect of family pension if a member of the armed forces dies in the course of operational duties. Hence, if captain Amit had died in the course of operational duties, the family pension received by widow of captain Amit is fully exempt from tax.

Readers Note:

Practical 12

An educational institution having annual receipts of Rs. 1.20 crore during the P.Y. 2016-17, has to make an application to the prescribed authority before 31.3.2018 for claiming tax exemption under section 10(23C). Discuss the correctness or otherwise of this statement

Solution

According to the first proviso to section 10(23C), an educational institution having aggregate of annual receipts greater than Rs. 1 crore, is required to make an application to the prescribed authority for grant of exemption under section 10(23C)(vi). Further, it is provided that such application can be made on or before 30th September of the relevant assessment year from which the exemption is sort.

Therefore, in the given case, the educational institution (having annual receipts of Rs. 1.20 crore during the P.Y.16-17) can make an application for grant of exemption in the prescribed form to the prescribed authority on or before 30th September, 2017, for claiming exemption u/s 10(23C)(vi) for P.Y 16-17.

Considering the above, the statement is not correct.

Readers Note:

Practical 13

Raksha Shakti University is claiming exemption under section 10(23C) (iiiab) since inception. During previous year **2017-18**, its gross receipts is Rs.3.8 crore, break up of which is as under:-

Sr. No.	Particulars	Amount (Rs. In crores)
1.	Collection of Fees	2.00
2.	Government Grant	1.60
3.	Voluntary Contributions	0.20

In the course of assessment proceedings, Assessing Officer denies exemption under section 10(23C)(iiiab) on the ground that it is not a substantially financed university by the Government. Verify the correctness of stand taken by assessing officer.

Solution

In case of Raksha Shakti University, for the previous year **2017-18**, percentage of Government Grants as to **total receipts including voluntary contributions** comes to 42.10% [1.60 crore ÷ 3.80 crore] which is not exceeding 50%. Therefore, it is not a substantially financed university for the purpose of section 10(23C)(iiiab). Therefore, stand taken by assessing officer is correct.

Readers Note:

Practical 14

Compute taxable income of NSDL Investor Protection Fund from the following information:

Particulars	Rs. (in crores)
Contribution received from NSDL	18.50
Contribution received from public	1.05
Interest on securities	7.20
Fixed Deposit interest	1.30
Further, investor protection fund shared to NSDL (which was not taxed earlier)	1.00

Solution

Computation of Taxable Income of NSDL Investor Protection Fund

Particulars	Rs. (in crores)
Contribution from NSDL	Exempt
Contribution from public	1.05
Interest on securities	7.20
Fixed Deposit interest	1.30
Investor protection fund shared to NSDL (which was not taxed earlier)	1.00
Total Income	**10.55**

Readers Note:

Practical 15

From the following information, compute taxable income of Core Settlement Guarantee Fund set up by National Securities Clearing Corporation Limited (NSCCL).

Particulars	Rs. in crores
Contribution received from NSCCL	18.50
Contribution received from National Stock Exchange Ltd being a shareholder of NSCCL	2.50
Contribution received from Clearing Members	0.50
Contribution received from Public	0.05
Income by way of penalties imposed on Clearing Members	1.25
Interest income from various investments	1.30
Amount Shared to NSCCL (which was not taxed earlier)	1.00

Solution

Computation of Taxable Income of Core Settlement Guarantee Fund Set up by NSCCL

Particulars	Rs. in crores
Contribution received from NSCCL	Exempt
Contribution received from National Stock Exchange Ltd being a shareholder of NSCCL	Exempt
Contribution received from Clearing Members	Exempt
Contribution received from Public	0.05
Income by way of penalties imposed on Clearing Members	Exempt
Interest income from various investments	Exempt
Amount Shared to NSCCL (which was not taxed earlier)	1.00
Total Income	**1.05**

Readers Note:

Practical 16

Mr. Zinga is a Sikkimese individual and he resides in Sikkim. He provides following information:

Sr. No.	Nature of Income	Rs.
1.	Income from business in Sikkim	2,00,000
2.	Income from business in Punjab	1,20,000
3.	Interest on fixed deposit with State Bank of India, Sikkim branch	42,000
4.	Interest on fixed deposit with State Bank of India, Delhi branch	12,000
5.	Interest on deb. of Tata Motors Ltd. having registered office in State of Gujarat	15,000
6.	Dividend income from Shares of Micro Soft Inc. USA	22,000
7.	Income from letting of house property situated at Sikkim	18,000

Compute taxable income of Mr. Zinga.

Solution

Considering the provisions of sec. 10(26AAA), computation of taxable income of Mr. Zinga is as under:

Sr. No.	Nature of Income	Rs.
1.	Income from business in Sikkim	Exempt
2.	Income from business in Punjab	1,20,000
3.	Interest on fixed deposit with State Bank of India, Sikkim branch	Exempt
4.	Interest on fixed deposit with State Bank of India, Delhi branch	12,000
5.	Interest on deb. of Tata Motors Ltd. having registered office in State of Gujarat	Exempt
6.	Dividend income from Shares of Micro Soft Inc. USA	Exempt
7.	Income from letting of house property situated at Sikkim	Exempt
	Taxable Income	**1,32,000**

Readers Note:

Practical 17

Does your answer differ, if above incomes are earned by Miss Zingi, a sikkemese woman who got married to Non-sikkemese Individual Mr. Raj in the year 2010.

Solution

Since Miss Zingi married non-sikkimese individual (on or after 01.4.2008), she will not qualify for exemption u/s 10(26AAA).

Considering the above, computation of taxable income of Mr. Zingi is as under:

Sr. No.	Nature of Income	Rs.
1.	Income from business in Sikkim	2,00,000
2.	Income from business in Punjab	1,20,000
3.	Interest on fixed deposit with State Bank of India, Sikkim branch	42,000
4.	Interest on fixed deposit with State Bank of India, Delhi branch	12,000
5.	Interest on deb. of Tata Motors Ltd. having registered office in State of Gujarat	15,000
6.	Dividend income from Shares of Micro Soft Inc. USA	22,000
7.	Income from letting of house property situated at Sikkim	18,000
	Taxable Income	**4,29,000**

Readers Note:

Practical 18

Mr. Nayankumar is a member of Union Public Service Commission. He provides following information:

Particulars	**Amount**
Basic Pay	Rs. 1,50,000 p.m.
Dearness Allowance	Rs. 15,000 p.m.
Transport Allowance	Rs. 12,000 p.m.
Servant allowance	Rs. 3,000 p.m.
Sumptuary allowance	Rs. 5,000 p.m.
Rent Free official residence	Annual License fee : Rs. 3,00,000
Value of leave travel concession(this is fourth journey in a block)	Rs. 75,000

Compute taxable salary of Mr. Nayankumar.

Solution

Notification No. 49/2010 dated 06.09.2011 under section 10(45)

In case of **serving Chairman and members** of Union Public Service Commission :—

(i) the value of rent free official residence;

(ii) the value of conveyance facilities including transport allowance;

(iii) the sumptuary allowance;

(iv) the value of leave travel concession provided to a serving Chairman or member of the Union Public Service Commission and members of his family.

In case of the **retired Chairman and retired members** of the Union Public Service Commission:—

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

(ii) the value of a residential telephone free of cost and the number of free calls to the extent of 1500 per month (over and above the number of free calls per month allowed by the telephone authorities).

Computation of taxable salary of Mr. Nayankumar

Particulars		**Amount in (Rs.)**
Basic Pay	Rs. 1,50,000 p.m. X 12 months	18,00,000
Dearness Allowance	Rs. 15,000 p.m.	1,80,000
Transport Allowance	Rs. 12,000 p.m.	Exempt
Servant allowance	Rs. 3,000 p.m.	36,000
Sumptuary allowance	Rs. 5,000 p.m.	Exempt
Rent Free official residence	Annual License fee : Rs. 3,00,000	Exempt
Value of leave travel concession (this is fourth journey in a block)	Rs. 75,000	Exempt
Taxable Salary		**20,16,000**

Readers Note:

DIVISION B

FIVE HEADS OF INCOME, SET OFF, CLUBBING, DEDUCTION FROM GTI AND COMPUTATION OF TAX LIABILITY

3 – SALARY

3.1 MEANING OF SALARY

Section:- 17(1)

The terms "salary" is defined to include following:

(a) Wages;
(b) Any annuity or pension;
(c) Any gratuity;
(d) Any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;
(e) Any advance of salary;
(f) Any payment received by an employee in respect of any period of leave not availed by him;
(g) The portion of the annual accretion in any previous year to the balance at the credit of an employee participating in a recognised provident fund (to the extent it is taxable);
(h) Transferred balance in a recognised provident fund (to the extent taxable);
(i) Contribution by the Central Government or any other employer to the account of an employee under a pension scheme referred to in Section 80CCD.

3.2 BASIS OF CHARGE

Section:- 15

As per Section 15, salary consists of the following:

(a) any salary due from an employer or a former employer to an assessee in the previous year, whether actually paid or not;
(b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;
(c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Points to be kept in mind:

(1) Once salary is taxed on receipt/due basis, it will not be taxed again on receipt/falling due, as the case may be.
(2) Any salary, bonus, commission or remuneration, by whatever name called, due to or received by, a partner of a Firm from the firm is not regarded as salary under this head.
(3) The assessee can claim relief u/s 89(1) for arrears or advance salary.

3.3 DEDUCTIONS FROM SALARIES

Section:- 16

(1) Entertainment Allowance {Section 16(ii)}

Entertainment allowance received from employer is firstly included in salary and then deduction u/s 16(ii) will be allowed only to Government employees which is least of the following:

(a) Rs.5000/-

(b) 20% of Basic salary

(c) Actual amount of entertainment allowance

(2) Professional Tax or Tax on Employment {Section 16(iii)}

Professional tax or tax on employment levied under article 276(2) of the Constitution is allowed as a deduction.

3.4 EXEMPTION UNDER SECTION 10

Section:- 10(5), 10(10), 10(10AA), 10(10B), 10(11), 10(12), 10(13), 10(13A), 10(14)

(1) Gratuity – Section 10(10)

Particulars	Exemption
Gratuity in the case of employees of Central Government, State Government and Local Authority.	Fully exempt u/s 10(10)(i)
Gratuity in case of employees covered by Payment of Gratuity Act, 1972	Least of the following: 1. [15 26] x Salary last drawn x completed years of service or part thereof in excess of 6 months 2. Rs. 10,00,000 3. Actually received. Note: Salary for this purpose = Basic Pay + Entire Dearness Allowance
Gratuity in case of any other employee.	Lower of following amount. 1. 1/2 x average salary x completed years of service *(ignore fraction)* 2. Rs. 10,00,000 3. Actually received. **Notes:** 1. Average Salary = Average Salary of last 10 months preceding month of retirement. 2. Salary for this purpose = Basic Pay + Dearness Allowance (forming part of retirement benefits) + Commission based on the % of turnover.

Notes:

1. Maximum exemption available under this section during the lifetime of the assessee cannot exceed Rs. 10,00,000.
2. Gratuity received during continuation of service is not exempt under this section. However, assessee can claim relief under section 89 of the Act.

(2) Pension 10(10A)

Particulars	Exemption
A. Uncommuted pension received by Government as well as non-Government employee.	Fully **taxable** as salary.
B. Commuted pension received by Government employee.	Fully exempt from tax u/s 10(10A)(i)
C. Commuted pension received by non-Government employee.	
1. If such employee receives gratuity.	1/3rd of full value of commuted pension shall be exempt u/s 10(10A)(ii)
2. If such employee does not receive gratuity.	1/2 of full value of commuted pension shall be exempt u/s 10(10A)(ii)

(3) Leave Salary – Section 10(10AA)

Particulars	Exemption
Encashment of leave at the time of retirement	
1. Central or State Government Employees	Fully exempt from tax u/s 10(10AA)(i)
2. For any other employees	Least of the following is exempt: 1. Earned leave (See Note 1) x Average salary (See Note2) 2. Avg. monthly salary x 10 Months 3. 3,00,000 4. Amount Actually received

Note 1: Earned Leave – Consider following steps

(a) No. of actual years of service

(b) No. of leave entitlement for each completed year of service as per rules of the employer (subject to the limit of 30 days)

(c) Gross total leave (in days) [step (a) x step (b)]

(d) Less: Leave availed

(e) Less: Leave encashed during the year

(f) Earned Leave (in no. of days) [step (c) – (d) – (e)]

(g) Earned leave (in months) [Step (f) / 30 days]

Note 2: Average monthly salary for this purpose means avgerage salary drawn in past 10 months immediately preceding the retirement.

Salary for this purpose = Basic Pay + Dearness Allowance (forming part of retirement benefits) + Commission based on the % of turnover

(4) Retrenchment Compensation – Section 10(10B)

Compensation received at time of retrenchment, is exempt from tax to the extent of lower of the following:

(a) The amount of compensation actually received.

(b) Rs. 5,00,000

(c) 15 days average pay for **every** completed years of continuous service or any part in excess of six months.

(5) House Rent Allowance (HRA) – Section 10(13A) and Rule 2A

The least of the following is exempt

(1) 40% of salary [50% if house situated at Mumbai, Kolkata, Delhi or Chennai]

(2) HRA actually received only in respect of the period during which the accommodation is occupied on rent.

(3) Excess of rent paid over 10 % of salary.

Salary for this purpose = Basic + Dearness Allowance (if part of retirement benefit) + Commission (fixed % of turnover).

(6) Allowances

(a) Allowances Fully taxable in all cases:

1. City Compensatory Allowance
2. Fixed Medical Allowance
3. Tiffin/Lunch/Dinner/Refreshment Allowance
4. Servant Allowance
5. Dearness Allowance
6. Project Allowance
7. Overtime Allowance
8. Interim Allowance
9. Any Other Cash Allowance

(b) Allowances exempted to the extent of **Amount received or specified limit (given below) whichever is less.**

Sr. No.	Allowances	Exemptions limits
1.	Children Education allowance	Rs. 100 p.m per child maximum 2 children
2.	Children hostel exp. allowance	Rs. 300 p.m per child maximum 2 children
3.	Tribal area allowance	Rs. 200 p.m
4.	Transport allowance (between residence & office)	Rs. 1600p.m & Rs. 3200 p.m for blind/handicapped
5.	Transport allowance for transport employee (During the course of transport)	Least of 70% of allowance or Rs. 10,000 p.m.
6.	Underground allowance	Rs. 800 p.m
7.	Compensatory field area allowance	Rs.2600 p.m.

8.	Compensatory modified Field area allowance	Rs. 1000 p.m.
9.	Special Compensatory hill area or high altitude	Rs. 300 p.m to Rs. 7000 p.m depending upon the location
10.	Border area, Remote area, Disturbed area allowance	Rs.200 p.m to Rs.1300 p.m.
11.	Island allowance to member of armed force	Limit is ₹ 3,250 p.m.
12.	Counter Insurgency Allowance	Limit is ₹ 3,900 p.m.

(7) Valuation Of Leave Travel Concession (LTC) [Section 10(5)]

Any concession received by employee for himself or his family for travelling to any place in India is exempt to the extent of amount spent subject to the following conditions:

1. Exemption only for two journeys in a block of four years and out of two journeys. [Current block: 1st January, 2014- 31st December, 2017]
2. Exemption only for two children but exemption will be available for all children born before October 1, 1998
3. Exemption shall not be available if the family members are travelling separately without the employee – Circular No. 8 / 2012.

Consider the following situations and relevant exemptions for LTC

Situations	Amount of exemption
Where journey is performed by air	Amount of economy class air fare of the national carrier by shortest route or amount spent whichever is less
Where journey is performed by rail	Amount of air-conditioned first class rail fare by the shortest route or amount spent whichever is less
Where the place of origin of journey and destination are connected by rail and journey is performed by any other mode of transport	Amount of air-conditioned first class rail fare by the shortest route or amount spent whichever is less
Where the place of origin of journey and destination are not connected by rail	
(a) where a recognised public transport exists	First class or de luxe class fair by the shortest route or the amount spent whichever is less
(b) where no recognised public transport exists	Air conditioned first class rail fare by shortest route or the amount spent whichever is less

3.5 PERQUISITES

Section:- 17(3)

Perquisite includes:

(1) The value of rent free accommodation provided to the employee by his employer;

(2) The value of any concession in the matter of rent in respect of any accommodation provided to the employee by his employer;

(3) The value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases:

- **(a)** By a company to an employee who is a director of such company;
- **(b)** By a company to an employee who has a substantial interest in the company;
- **(c)** By an employer (including a company)to an employee, who is not covered by (i) or (ii) above and whose income under the head "Salaries" (whether due from or paid or allowed by one or more employers), exclusive of the value of all benefits and amenities not provided by way of monetary payment, exceeds Rs.50,000/-.

(4) Any sum paid by the employer in respect of any obligation which would otherwise have been payable by the assessee.

(5) Any sum payable by the employer, whether directly or through a fund, other than a recognized provident fund or an approved superannuation fund or other specified funds u/s 17, to effect an assurance on the life of an assessee or to effect a contract for an annuity.

(6) 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 employee.

(7) 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 and fifty thousand rupees (w.e.f. 01.04.2017); and

(8) The value of any other fringe benefit or amenity as prescribed in Rule 3.

3.6 RENT FREE ACCOMMODATION

Rule:- 3(1)

"Accommodation" includes a house, flat, farm house or part thereof, hotel accommodation, motel, service apartment, guest house, a caravan, mobile home, ship or other floating structure.

(a) For **valuation of the perquisite of rent free unfurnished accommodation**, all employees are divided into two categories:

- **(i)** For employees of the Central and State governments the value of perquisite shall be **equal to the licence fee charged for such accommodation as reduced by the rent actually paid by the employee. Employees of autonomous, semi-autonomous institutions, PSUs/PSEs & subsidiaries, Universities, etc. are not covered under this method of valuation.**

(ii) For all others, i.e., those salaried taxpayers not in employment of the Central government and the State government, the valuation of perquisite in respect of accommodation would be at prescribed rates, as discussed below:

(1) Where the accommodation provided to the employee is **owned by the employer**

Sr. No.	Cities having population as per the 2001 census	Perquisite
(1)	Exceeds 25 lakh	15% of salary
(2)	Exceeds 10 lakhs but does not exceed 25 lakhs	10% of salary
(3)	For other places	7.5% of salary

(2) Where the accommodation so provided is taken **on lease/ rent by the employer:**

The prescribed rate is 15% of the salary or the actual amount of lease rental payable by the employer, whichever is lower, as reduced by any amount of rent paid by the employee. Meaning of 'Salary 'for the purpose of calculation of perquisite in respect of Residential Accommodation:

a. Basic Salary ;
b. Dearness Allowance, or Dearness Pay if it enters into the computation of superannuation or retirement benefit of the employees;
c. Bonus ;
d. Commission ;
e. All other taxable allowances (excluding the portion not taxable); and
f. Any monetary payment which is chargeable to tax (by whatever name called).

Salary from all employers shall be taken into consideration in respect of the period during which an accommodation is provided. Where on account of the transfer of an employee from one place to another, he is provided with accommodation at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower value for a period not exceeding 90 days and thereafter the value of perquisite shall be charged for both such accommodation.

(b) Valuation of the perquisite of furnished accommodation- the value of perquisite as determined by the above method [in (a)] shall be increased by-

(i) 10% of the cost of furniture, appliances and equipments, or

(ii) where the furniture, appliances and equipments have been taken on hire, by the amount of actual hire charges payable

and the value so arrived at shall be reduced by any charges paid by the employee himself

(c) Furnished Accommodation in a Hotel: The value of perquisite shall be determined on the basis of lower of the following two:

(i) 24% of salary paid or payable in respect of period during which the accommodation is provided; or

(ii) Actual charges paid or payable by the employer to such hotel,

for the period during which such accommodation is provided as reduced by any rent actually paid or payable by the employee.

However, nothing in (c) shall be taxable if following two conditions are satisfied:

(1) The hotel accommodation is provided for a total period not exceeding in aggregate 15 days in a previous year, and

(2) Such accommodation is provided on an employee's transfer from one place to another place

(d) However, the value of any accommodation provided to an employee working at a mining site or an on-shore oil exploration site or a project execution site or a dam site or a power generation site or an off-shore site will not be treated as a perquisite if:

(i) such accommodation is located in a "remote area" or

(ii) where it is not located in a "remote area", the accommodation is of a temporary nature having plinth area of not more than 800 square feet and should not be located within 8 kilometers of the local limits of any municipality or cantonment board.

A project execution site here means a site of project up to the stage of its commissioning. A "remote area" means an area located at least 40 kilometers away from a town having a population not exceeding 20,000 as per the latest published all-India census

3.7 VALUATION OF PERQUISITES IN RESPECT OF FREE DOMESTIC SERVANTS / PERSONAL ATTENDANTS

Rule:- 3(3)

- The value of free service of all personal attendants including a sweeper, gardener and a watchman is to be taken at actual cost to the employer.
- Where the attendant is provided at the residence of the employee, full cost will be taxed as perquisite in the hands of the employee irrespective of the degree of personal service rendered to him.
- Any amount paid by the employee for such facilities or services shall be reduced from the above amount.

3.8 VALUATION OF GAS, ELECTRICITY OR WATER SUPPLIED BY EMPLOYER

Rule:- 3(4)

- The value of perquisite in the nature of gas, electricity and water shall be the amount paid by the employer.
- Where the supply is made from the employer's own resources, the manufacturing cost per unit incurred by the employer would be taken for the valuation of perquisite.
- Any amount paid by the employee for such facilities or services shall be reduced from the perquisite value.

3.9 VALUATION OF FREE OR CONCESSIONAL EDUCTIONAL FACILITIES

Rule:- 3(5)

- Perquisite on account of free or concessional education for any member of the employee's household shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf.
- However, where such educational institution itself is maintained and owned by the employer or where such free educational facilities are provided in any 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 a similar institution in or near the locality if the cost of such education or such benefit per child exceeds Rs.1000/- p.m.
- The value of perquisite shall be reduced by the amount, if any, paid or recovered from the employee.

3.10 VALUE OF INTEREST FREE LOAN

Rule:- 3(7)(i)

It is common practice, particularly in financial institutions, to provide interest free or concessional loans to employees or any member of his household. The value of perquisite arising from such loans would be the excess of interest payable at **prescribed interest rate** over interest, if any, actually paid by the employee or any member of his household. The **prescribed interest rate would now be the rate charged per annum by the State Bank of India as on the 1st day of the relevant financial year in respect of loans of same type and for the same purpose advanced by it to the general public.** Perquisite value would be calculated on the basis of the maximum outstanding monthly balance method. For valuing perquisites under this rule, any other method of calculation and adjustment otherwise adopted by the employer shall not be relevant. However, small loans up to Rs. 20,000/- in the aggregate are exempt.

Loans for medical treatment of diseases specified in Rule 3A are also exempt, provided the amount of loan for medical reimbursement is not reimbursed under any medical insurance scheme. Where any medical insurance reimbursement is received, the perquisite value at the prescribed rate shall be charged from the date of reimbursement on the amount reimbursed, but not repaid against the outstanding loan taken specifically for this purpose

3.11 VALUE OF PERQUISITE IN RESPECT OF MOVABLE ASSETS

Rule:- 3(7)(vii) and 3(7)(viii)

(A) Use of assets [Rule 3(7)(vii)]: It is common practice for a movable asset (other than those referred in other sub rules of rule 3) owned by the employer to be used by the employee or any member of his household. This perquisite is to be charged at the rate of 10% of the original cost of the asset as reduced by any charges recovered from the employee for such use. However, the use of Computers and Laptops would not give rise to any perquisite.

(B) Transfer of assets [Rule 3(7)(viii)]: Often an employee or member of his household benefits from the transfer of movable asset (not being shares or securities) at no cost or at a cost less than its market value from the employer. The difference between the original cost of the movable asset (not being shares or securities) and the sum, if any, paid by the employee, shall be taken as the value of perquisite. In case of a movable asset, which has already been put to use, the original cost shall be reduced by a sum of 10% of such original cost for every completed year of use of the asset. Owing to a higher degree of obsolescence, in case of computers and electronic gadgets, however, the value of perquisite shall be worked out by reducing 50% of the actual cost by the reducing balance method for each completed year of use. Electronic gadgets in this case means data storage and handling devices like computer, digital diaries and printers. They do not include household appliance (i.e. white goods) like washing machines, microwave ovens, mixers, hot plates, ovens etc. Similarly, in case of cars, the value of perquisite shall be worked out by reducing 20% of its actual cost by the reducing balance method for each completed year of use

3.12 VALUE OF MEDICAL FACILITIES

Section:- 17

The following shall not be treated as perquisite

(a) Medical treatment of the employee or his family (spouse and children, dependent-parents, brothers and sisters):

- Provided in any hospital maintained by the employer.
- Any sum paid by the employer towards expenditure actually incurred by the employee in any hospital:
  - Maintained by employer or Government or Local Authority or any other hospital approved by Central Government for the purposes of medical treatment of its employees;
  - Approved by the Chief Commissioner having regard to the prescribed guidelines in respect of prescribed diseases.

(b) Premium paid by an employer by cheque to General Insurance Corporation to effect/keep in force:

- Insurance on the health of his employees.
- Medical Insurance Premium.

(c) Any sum, not exceeding ₹ 15,000 paid to any hospital/nursing home/clinic other than (a & b)

(d) Amount payable for treatment Outside India:

- Medical expenses to the extent permitted by RBI.
- If Gross Total Income (before including the travel expenditure) of the employee, does not exceed ₹ 2,00,000/-, then travel abroad for patient and one attendant fully deductible. Stay abroad for patient and one attendant - permitted by RBI

3.13 VALUE OF MOTOR CAR

Rule:- 3(2)

(a) If an employer provides motor car facility to his employee, the value of such perquisite shall be :

(i) Nil, if the motor car is used by the employee wholly and exclusively in the performance of his official duties.

(ii) Actual expenditure incurred by the employer on the running and maintenance of motor car including remuneration to chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use (in case the motor car is exclusively for private or personal purposes of the employee or any member of his household).

(iii) Rs. 1800/- (plus Rs. 900/-, if chauffeur is also provided) per month (in case the motor car is used partly in performance of duties and partly for private or personal purposes of the employee or any member of his household if the expenses on maintenance and running of motor car are met or reimbursed by the employer). However, the value of perquisite will be Rs. 2400/-(plus Rs. 900/-, if chauffeur is also provided) per month if the cubic capacity of engine of the motor car exceeds 1.6 litres.

(iv) Rs. 600/- (plus Rs. 900/-, if chauffeur is also provided) per month (In case the motor car is used partly in performance of duties and partly for private or personal purposes of the employee or any member of his household if the expenses on maintenance and running of motor car for such private or personal use are fully met by the employee). However, the value of perquisite will be Rs. 900/- (plus Rs. 900/-, if chauffeur is also provided) per month if the cubic capacity of engine of the motor car exceeds 1.6 litres.

(b) If the motor car or any other automotive conveyance is owned by the employee but the actual running and maintenance charges are met or reimbursed by the employer, the method of valuation of perquisite value is different and as below:

(i) where the motor car or any other automotive conveyance is owned by the employee but actual maintenance & running expenses (including chauffeur salary, if any) are met or reimbursed by the employer, no perquisite shall be chargeable to tax if the car is used wholly and exclusively for official purposes. However following compliances are necessary:

- The employer has maintained complete details of the journey undertaken for official purposes;
- The employer gives a certificate that the expenditure was incurred wholly for official duties.

(ii) However if the motor car is used partly for official or partly for private purposes then the amount of perquisite shall be the actual expenditure incurred by the employer as reduced by the amounts in c) referred to in (1) above.

Normal wear and tear of the motor shall be taken at 10 % per annum of the actual cost of the motor car

3.14 CARRIAGE OF PASSENGER GOODS

Rule:- 3(6)

The value of any benefit or amenity resulting from the provision by an employer, who is engaged in the carriage of passengers or goods, to any employee or to any member of his household for personal or private journey free of cost or at concessional fare, in any conveyance owned, leased or made available by any other arrangement by such employer for the purpose of transport of passengers or goods shall be taken to be the value at which such benefit or amenity is offered by such employer to the public as reduced by the amount, if any, paid by or recovered from the employee for such benefit or amenity. This will not apply to the employees of any airline or the railways

3.15 PERQUISITE ON ACCOUNT OF TRAVELLING, TOURING, ACCOMMODATION AND ANY OTHER EXPENSES PAID FOR OR REIMBURSED BY THE EMPLOYER FOR ANY HOLIDAY AVAILED

Rule:- 3(7)(ii)

The value of perquisite on account of travelling, touring, accommodation and any other expenses paid for or reimbursed by the employer for any holiday availed of by the employee or any member of his household, other than leave travel concession (as per section 10(5)), shall be the amount of the expenditure incurred by the employer in that behalf. However, any amount recovered from or paid by the employee shall be reduced from the perquisite value so determined.

Where such facility is maintained by the employer, and is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public. If a holiday facility is maintained by the employer and is available uniformly to all employees, the value of such benefit would be exempt.

Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure with respect to the member of the household shall be a perquisite

3.16 VALUE OF SUBSIDIZED / FREE FOOD / NON-ALCOHOLIC BEVERAGES PROVIDED BY EMPLOYER TO AN EMPLOYEE

Rule:- 3(7)(iii)

Value of taxable perquisite is calculated as under:

Expenditure incurred by the employer on the value of food / non-alcoholic beverages including 'paid vouchers which are not transferable and usable only at eating joints'	xxx
Less: Fixed value of a sum of Rs. 50/- per meal	(xxx)
Less: Amount recovered from the employee	(xxx)
Balance amount is the taxable as perquisites on the value of food provided to the employees	xxx

Note:- Exemption is given in following situations:

(1) Tea / snacks provided in working hours.

(2) Food & non-alcoholic beverages provided in working hours in remote area or in an offshore installation.

3.17 MEMBERSHIP FEES AND ANNUAL FEES

Rule:- 3(7)(v)

Any membership fees and annual fees incurred by the employee (or any member of his household), which is charged to a credit card (including any add-on card) provided by the employer, or otherwise, paid for or reimbursed by the employer is taxable on the following basis:

Amount of expenditure incurred by the employer	xxx
Less : Expenditure on use for official purposes	(xxx)
Less : Amount, if any, recovered from the employee	(xxx)
Amount taxable as perquisite	xxx

However if the amount is incurred wholly and exclusively for official purposes it will be exempt if the following conditions are fulfilled

(1) Complete details of such expense, including date and nature of expenditure, is maintained by the employer.

(2) Employer gives a certificate that the same was incurred wholly and exclusively for official purpose.

3.18 CLUB EXPENDITURE

Rule:- 3(7)(vi)

Any annual or periodical fee for Club facility and any expenditure in a club by the employee (or any member of his household), which is paid or reimbursed by the employer is taxable on the following asis:

Amount of expenditure incurred by the employer	xxx
Less : Expenditure on use for official purposes	(xxx)
Less : Amount, if any, recovered from the employee	(xxx)
Amount taxable as perquisite	Xxx

However if the amount is incurred wholly and exclusively for official purposes it will be exempt if the following conditions are fulfilled

(1) Complete details of such expense, including date and nature of expenditure and its business expediency is maintained by the employer.

(2) Employer gives a certificate that the same was incurred wholly and exclusively for official purpose.

Note:

a. Health club, sport facilities etc. provided uniformly to all classes of employee by the employer at the employer's premises and expenditure incurred on them are exempt.

b. The initial one-time deposits or fees for corporate or institutional membership, where benefit does not remain with a particular employee after cessation of employment are exempt. Initial fees / deposits, in such case, is not included.

3.19 GIFTS

Rule:- 3(7)(iv)

The value of any gift or vouchers or token in lieu of which such gift may be received, given by the employer to the employee or member of his household, is taxable as perquisite. However gift, etc less than Rs. 5,000 in aggregate per annum would be exempt.

3.20 VALUE OF ANY SPECIFIED SECURITY OR SWEAT EQUITY SHARES ALLOTTED TO EMPLOYEE

Section:-

(1) Specified Security means the securities as defined in Section 2(h) of the Securities Contracts (Regulation) Act, 1956 and also includes securities offered under Employees Stock Option Plan (ESOP).

(2) 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 nature of Intellectual Property Rights.

(3) Perquisite will be taxable as the difference between the fair market value (FMV) of the shares as on the date of exercise of the options less the exercise price.

(4) For this purpose, FMV shall be determined as under:

(a) Listed shares:

Particulars	FMV
If shares traded on recognized stock exchange on the date of exercise option	
Listed on a recognized stock exchange	Average of opening and closing price on that date
Listed on more than one recognised stock exchanges	Average of opening & closing price of share on the recognised stock exchange which records the highest volume of trading in the share
If no trading in the share on any recognised stock exchange	
If share listed on a recognised stock exchange	Closing price of share on any recognised stock exchange on a date closest to date of exercising the option & immediately preceding such date
If share listed on more than one recognised stock exchanges	Closing price of share on a recognised stock exchange, which records highest volume of trading in such share

(b) Unlisted shares : Fair market value shall be determined by a merchant banker on the specified date.

3.21 PROFITS IN LIEU OF SALARY

Section:- 17(3)

(1) the amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto;

(2) any payment (other than any payment referred to in clauses (10), (10A), (10B), (11), (12) (13) or (13A) of section 10 due to or received by an 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 contributions by the assessee or interest on such contributions or any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

(3) "Keyman insurance policy" shall have the same meaning as assigned to it in section 10(10D);

(4) 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.

3.22 PROVIDENT FUND

Section:- 10(11)

Particulars	Statutory Provident Fund	Recognised Provident Fund	Unrecognised Provident Fund	Public Provident Fund
Employer's contribution to provident fund	Not taxable	Not taxable up to 12 per cent* of salary	Not taxable	Employer does not contribute
Employee's contribution- Whether eligible for deduction u/s 80C?	Eligible	Eligible	Not eligible	Eligible
Interest credited	Not taxable	Exempt up to 9.5% - Excess interest taxable	Not taxable at the time of credit	Not taxable
Lump sum payment received at the time of retirement or termination of service or withdrawn	Exempt u/s 10(11)	Exempt from tax u/s10(12) subject to few conditions. If not exempt, then tax treatment shall be as if URPF	Employee's contribution not taxable, however, interest thereon is taxable under the head "Income from other sources". Employer's contribution and interest thereon is taxable as Profits in lieu of Salary under the head "Salaries"	Exempt from tax u/s 10(11)

Notes:- Salary means basic salary. It includes dearness allowance if terms of employment so provide. It also includes commission when determined at a fixed percentage of turnover achieved by an employee.

3.23 APPROVED SUPERANNUATION FUND

Section:- 10(13)

- Employers contribution towards an approved superannuation fund is chargeable to tax in the hands of employees to the extent such contribution exceeds Rs. 1.5 lakh per year
- Interest on accumulated fund balance is exempt from tax

3.24 CRITICAL JUDICIAL RULINGS IN QUESTION – ANSWER FORMAT

Case Study 1

Mr. Shiv Charan Mathur is a Member of Legislative Assembly. He underwent an open heart surgery abroad in respect of which he received Rs.5 Lacs from the State Government towards reimbursement of his medical expenses. The Assessing Officer contended that such amount is taxable as a perquisite under section 17. Discuss the correctness of the contention of the Assessing Officer.

Solution

Rajasthan High Court in case of CIT v. Shiv Charan Mathur (2008) 306 ITR 126 (Raj.) made following observations:-

(a) MPs and MLAs do not fall within the meaning of "employees". They are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations.

(b) The remuneration received by them, after swearing in, cannot be said to be salary within the meaning of section 15, since the basic ingredient of employer-employee relationship is missing in such cases.

(c) Therefore, the remuneration received by MPs and MLAs is taxable under the head "Income from Other Sources" and not under the head "Salaries".

(d) When the provisions of section 15 are not attracted to the remuneration received by MPs and MLAs, the provisions of section 17 also would not apply as section 17 only extends the definition of salary by providing that certain items mentioned therein would be included in salary as "perquisites".

Thus, reimbursement of medical expenditure (incurred for open heart surgery abroad) to an MLA cannot be taxed as a perquisite under section 17. Therfore, the contention of the Assessing Officer is not correct.

Reader's Note:

Case Study 2

Shankar Krishna was provided with rent-free accommodation, being a flat in Mumbai, by his employer company. The monthly rent paid by the employer in respect of the said flat was Rs.10,000 per month. The employer had given an interest-free refundable security deposit of Rs.30 lacs to the landlord for renting out the said premises. The assessee-employee computed the perquisite value on the basis of

rent of Rs.10,000 paid by his employer to the landlord, since the same was lower than 15% of salary. The assessing officer enhanced the perquisite value of residential accommodation by notional interest @ 12 % on the refundable security deposit. Whether action of assessing officer is justified?

Solution

Bombay High court in case of CIT v. Shankar Krishnan (2012) 349 ITR 0685 (Bom.) held that the Assessing Officer is not right in adding the notional interest on the security deposit given by the employer to the landlord in valuing the perquisite of rent-free accomodation, since the perquisite value has to be computed as per Rule 3 and Rule 3 does not require addition of such notional interest.

Reader's Note:

Case Study 3

Sub-rule (5) of Rule 3 deals with valuation of perquisite in respect of free or concessional education facility provided by the employer. This rule reads as under:

"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 or 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 a 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 Rs.1,000 per month."**

On referring this rule, can the limit of Rs.1,000 per month per child be allowed as standard deduction where cost of such education in a similar institution exceeds Rs.1,000?

Solution

The High Court in case of CIT (TDS) v. Director, Delhi Public School (2011) 202 Taxman 318 (Punj. & Har.) held that on a plain reading of Rule 3(5), it flows that, in case the value of perquisite for free/concessional educational facility arising to an employee exceeds Rs. 1,000 per month per child, the whole perquisite shall be taxable in the hands of the employee and no standard deduction of Rs. 1,000 per month per child can be provided from the same. It is only in case the perquisite value is less than Rs.1,000 per month per child, the perquisite value shall be nil.

Therefore, Rs. 1,000 per month per child is not a standard deduction to be provided while calculating such a perquisite

Reader's Note:

4 – HOUSE PROPERTY

4.1 BASIS OF CHARGE

Section:- 22

(a) Income is taxable under the head "Income from house property" if the following three conditions are satisfied:

(1)	The property should consist of any **buildings** or **lands appurtenant** thereto
(2)	The assessee should be **owner** of the property.
(3)	The **property** should **not be used** by the owner **for** the purpose of any **business** or profession **carried** on **by him**, the profits of which are chargeable to income-tax.

(b) On primary analysis of the above conditions, it is gained that section 22 nowhere requires that house property should be let out. That means, annual value of house property shall be assessed under this head even if assessee is not in receipt of actual rent income

(c) Few illustrations

(1) Mr. A owns house property which is self-occupied then annual value of such property shall be assessed under the head “Income from house property”.

(2) X owns a building. It is given on rent, Income of the property is taxable under the head "Income from house property”, as the above-noted three conditions are satisfied.

Practical 1

A Hindu undivided family owns a property which has been let out to a firm carrying on business. The family is a partner of the firm through its Karta. No rent has been charged by the HUF from the firm for use of the premises by the firm. The Assessing Officer, however, has taxed the family on the notional income from property based on municipal valuation. Is this decision justified?

Solution

In CIT v. Shri. Champalal Jeevraj (1995) 215 ITR 289 (Mad), it was observed that where the Karta of the HUF is a partner in the firm in his representative capacity and the firm occupied the house belonging to the HUF, the benefit of exclusion under section 22 was available to the HUF.

Hence, the income from the said property shall not be chargeable to tax under the head “Income from house property”.

Therefore, the action of the Assessing Officer taxing the notional income under the head house property is not in accordance with law.

Reader’s Note:

4.2 DETAILED ANALYSIS OF SECTION 22

Section:- 22

(a) "Building":- The word "building" is wide enough to include residential houses, buildings for office use, or for storage or for use as factory, music halls, dance halls, lecture halls etc.

(b) "Land appurtenant thereto"

The appurtenant lands may be in the form of approach roads, compounds, courtyards, backyards, playground, kitchen-garden, motor garage, cattle-shed, etc., attached to and forming part of building. If land is appurtenant to building then income therefrom shall be assessed under the head "house property" if other conditions of section 22 are satisfied.

But on the other hand, rental income of a vacant plot (that is to say, not appurtenant to building) is not chargeable to tax under the head "Income from house property", but is generally taxable under the head "Income from other sources".

(c) Assessee should be owner of the property

Income is taxable under the head, "Income from house property" only if the assessee is the owner of a house property.

Illustration- Mr. X owns a house property. He lets it out to Mr. Y and monthly rent is Rs. 25,000. Mr.Y sublets it to Mr.Z on monthly rent of Rs. 40,000. Then rental income of Mr. X is taxable under the head "Income from house property". *Since Mr. Y is not the owner of the house*, *his income is not taxable as under the head "Income from house property",* but is taxable as business income under section 28 or as income from other sources under section 56. **[Concept of Deemed Owner discussed in next para]**

(d) Property should not be occupied by the owner for his own business or profession

As per third condition to section 22, the annual value of house property shall be assessed under this head provided property should not be occupied by the owner for the purpose of his business or profession. Consider following illustrations and case studies:

(1) Y owns a building. It is used by him for carrying on his business or he uses the building as his office or factory or godown. In this case, no income is taxable under the head "Income from house property", as third condition is not satisfied.

(2) ABC Ltd. is a manufacturing company. The factory of the company is situated in a backward district of State Gujarat. Nearby factory campus, there is a residential colony having 400 quarters for workers. These quarters are given to the workers for residential purposes at token rent of Rs. 50 per month. As the purpose of letting out of residential quarters is to run the business smoothly, the residential quarters will be treated as house property used by the assessee for the purpose of its business. Accordingly, annual value thereof is not chargeable under section 22—CIT v. Delhi Cloth & General Mills Ltd. [1996] 59 ITR 152 (Punj.). Recovery of rent of Rs. 50 per month from the workers will be taxed under the head "Income from business or profession".

4.3 DEEMED OWNER

Section:- 27

Section 27 of the Act provides that the word "owner" includes a legal owner as well as deemed owner for the purpose of head “Income from House Property. Following is the list of deemed owner.

(a) Transfer to a spouse or minor child.

If following conditions should are satisfied, then the individual who has transferred property shall be deemed to be the “owner”.

(1) The taxpayer is an individual

(2) He or she transfers a house property.

(3) The property is transferred to his/her spouse (not being a transfer in connection with an arrangement to live apart) or to his/her minor child (not being a married daughter).

(4) The property is transferred without adequate consideration

Illustration – Mr. X owns a house property. He transfers the property without any consideration to his wife. For the purpose of taxing rental income, Mr. X will be deemed as "owner" of the property. Consequently, income would be taxable in the hands of Mr. X.

(b) Holder of impartible estate

The holder of impartible estate is deemed as owner of the property.

Illustration – Maharana Janak is one of the ex-Rulers of a former princely state. He has divided all his properties amongst his four sons. However, he could not divide a building, which is occupied by a temple and which is given, as per family convention, to his eldest son though other three sons have equal rights in this property. But for the purpose of section 22, the eldest son, as holder of "impartible estate", is deemed as "owner" of the property.

(c) Property held by a member of housing co-operative society

A member of co-operative society, company or other association of persons to whom a building is allotted under the house building scheme of the society, company or association, is treated as deemed owner of such property.

Illustration – Generally society is a registered owner of the property. But when a flat is allotted by a co-operative housing society to Mr. X, one of its members under the house building scheme of the society, then Mr. X is deemed as "owner" of the flat allotted to him.

(d) Holding possession of immovable property under part performance of contract

If a person has acquired a property under a "power of attorney transaction" by satisfying the conditions of section 53A of the Transfer of Property Act, he is deemed as owner of the property, although he may not be the "registered owner" of the property. Section 53A of the Transfer of Property Act requires the following conditions:

(1) There is an agreement in writing between the purchaser and the seller.

(2) The purchaser has paid the part (or full) consideration to the seller.

(3) The purchaser has taken the possession of the property from the seller though conveyance deed (sale deed) is not executed in favour of purchaser.

If the aforesaid three conditions are satisfied, the purchaser becomes the deemed "owner" of the property for the purpose of income-tax, even if he is not the registered owner of the property.

Illustration – Mr. X enters into a written agreement to purchase a property from Y for Rs. 45,00,000. He has paid the full consideration and taken possession of the property with effect from 15-01-2015. The sale deed was registered on 15-05-2015. Then Mr. X becomes deemed "owner" of the property for the purpose of this head with effect from 15-01-2015, although he became registered owner on 15-05-2015.

(e) Lease rights of a property

If a person acquires a right in a building by virtue of a transaction which is referred to in section 269UA(f), then he is deemed as owner of the property. Section 269UA(f) covers the case of giving a property on lease for a term of not less than 12 years (whether fixed originally or there is a provision for extension of term and the aggregate period is not less than 12 years). However, lease rights are given on month to month basis or for a period not exceeding one year then leasee shall not be considered as deemed owner.

Illustration -

(1) Mr. X owns a property. It is given on lease for a period of 12 years to Mr. Y, lease rent being Rs.25,000 per month. Then in this case Mr. Y becomes deemed "owner" of the property.

(2) Mr. X owns a property. It is given on lease for a period of 8 years to Mr. Y, lease rent being Rs.10,000 per month. Mr. Y has a right to get renewal of lease for further period of 6 years after the expiry of lease. In this case, the aggregate period of lease is 14 years. Therefore, Mr. Y is deemed as "owner" of the property.

(3) Mr. X owns a property, it is given on lease to Mr. Y for a period of three months, rent being Rs.35,000. Mr. Y has a right to get renewal of the lease subject to the condition that every time it will be renewed only for a period of 3 months and such renewal is possible with mutual consent for thirty years. In this case, though the aggregate period of lease is more than 12 years, but Mr. Y will not become deemed "owner" of the property, the reason is that property is given on lease for a period not exceeding one year.

4.4 DETERMINATION OF GROSS ANNUAL VALUE

Section:- 23

(a) Taxability under the head house property depends on Gross Annual Value (GAV):

(b) In order to determine the GAV, one should first understand the following terminology.

(1) Municipal Valuation - For collecting municipal taxes, local authorities make a periodical survey of all buildings in their jurisdiction and determine the value. Such valuation shall be termed as Municipal Valuation.

(2) Fair Rent - Fair rent of the property can be determined on the basis of a rent fetched by a similar property in the same or similar locality.

(3) Standard Rent - Standard rent is the maximum rent which a person can legally recover from his tenant under a Rent Control Act.

(c) Steps for computation Gross Annual Value

(1) Step 1: Municipal Valuation or Fair rent whichever is higher.

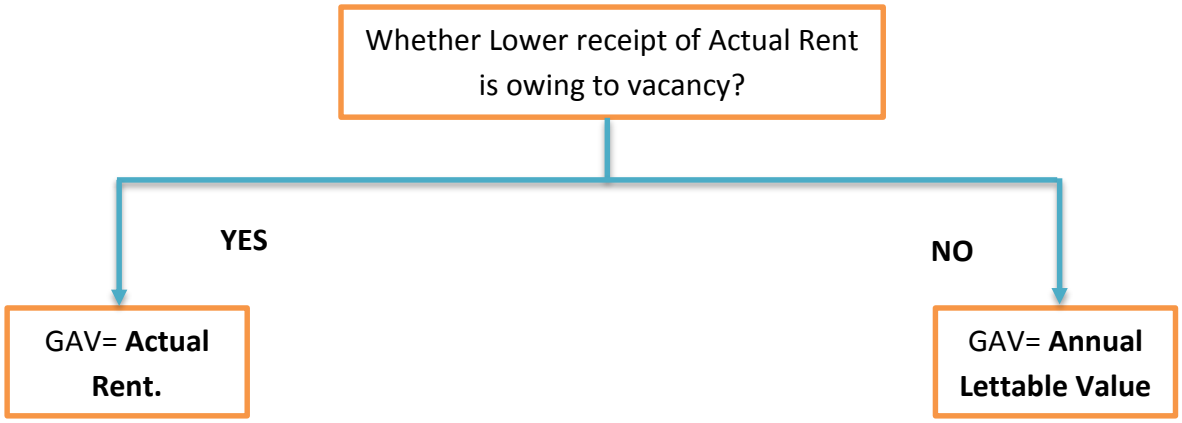
(2) Step 2: Step 1 or Standard Rent whichever is lower. (This is called Annual gettable Value i.e. ALV)

(3) Step 3: Step 2 (ALV) or Actual Rent received (AR) whichever is higher.

If answer at step3 is AR then GAV = AR.

Otherwise,

(4) Step 4:



Notes:- While calculating Actual Rent following shall be kept in mind:

(1) Here, Actual rent received= Annual Rent- Unrealised Rent-Loss due to vacancy.

(2) A non-refundable deposit will be included in Annual rent on pro rata basis.

(3) Advance rent shall not be considered while determining Annual Rent.

(4) Unrealised rent (which the owner could not realise) shall be excluded from Annual Rent only if all the following conditions are satisfied— Rule 4 of Income Tax Rules

(a) The tenancy is bona fide.

(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 satisfies the Assessing Officer that legal proceedings would be useless.

4.5 MUNICIPAL TAX AND NET ANNUAL VALUE

Section:- 23

From the gross annual value computed above, deduct municipal taxes levied by any local authority in respect of the house property. Municipal taxes are deductible only if

(a) these **taxes are borne by the owner,**

and

(b) are **actually paid by him during the previous year.**

The remaining amount left after deduction of municipal taxes is Net Annual Value (NAV).

4.6 DEDUCTION UNDER SECTION 24

Section:- 24(a) and 24(b)

The following two deductions are available under section 24 from Net Annual Value (NAV)

(a) Standard deduction; and

(b) interest on borrowed capital.

The list of deductions under section 24 is exhaustive (that means full and final). In other words, no other deduction can be claimed in respect of those expenditures which are not specified in this section. For instance, no deduction can be claimed in respect of insurance, repairs, collection charges, electricity, water supply, salary etc.

(a) Standard Deduction [Section 24(a)]

30 per cent of net annual value is deductible irrespective of any expenditure incurred by the taxpayer.

(b) Interest on Borrowed Capital [Section 24(b)]

Interest on borrowed capital is allowable as deduction on ***accrual basis***, if capital is borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the property.

The following points also merit consideration:—

(1) Interest on unpaid interest is not deductible.

(2) Interest on a fresh loan, taken to repay the original loan raised for the aforesaid purposes, is allowable as deduction—*Circular No. 28, dated August 20, 1969.*

(3) Any interest chargeable under the Act, in the hands of recipient and payable out of India, on which tax has not been paid or deducted at source, and in respect of which there is no person who may be treated as an agent, is not deductible, by virtue of section 25, in computing income chargeable under the head "Income from house property".

(4) In case of let out property, interest on borrowed capital is deductible without any limit.

(5) In case of self-occupied property, interest on borrowed capital is deductible subject to some limits.

(6) Interest of ***pre-construction period*** will also be deductible in five equal annual instalments, starting from the previous year in which house property is acquired or constructed.

Pre-construction period means the period:

commencing on the date of borrowing and ending on:

(a) 31st march immediately prior to date of completion of construction

or

(b) date of repayment of loan whichever is earlier

4.7 CALCULATION OF INCOME UNDER THE HEAD HOUSE PROPERTY UNDER DIFFERENT SITUATIONS

Situation 1 :- Where property is let out throughout the year

Income from a let out house property is determined as under:

Particulars	Rs.
Gross annual value	xxxx
Less : Municipal taxes	(xxxx)
Net annual value	xxxx
Less : Deduction under section 24	
(a) Standard deduction (30% of Net Annual Value)	(xxxx)
(b) Interest on borrowed capital (deductible on accrual basis without any limit)	(xxxx)
Income from house property	**xxxx**

Situation 2 :- Where property is self-occupied throughout the year:

Particulars	Rs.
Gross annual value	Nil
Less : Municipal taxes	Nil
Net annual value	Nil
Less : Deduction under section 24	
(a) Standard deduction (30% of Net Annual Value)	Nil
(b) Interest on borrowed capital subject to limit (Refer Note)	xxxx
Income from house property	**xxxx**

Note:- Interest (including pre-construction period interest) is deductible subject to following limits:

(1) If amount has been borrowed for purchase, construction, repair or renovation of house property, then interest is generally deductible upto Rs. 30,000 p.a.

(2) Above limit of Rs. 30,000 shall be increased to Rs. 2,00,000, if following conditions are satisfied:-

(i) Amount has been borrowed on or after 1st April 1999 and

(ii) Amount has been borrowed for purchase or construction of House Property and

(iii) Purchase or construction has been completed within five years from the end of financial year in which amount has been borrowed.

Practical 2

Mr. Gajanan provides following information:

(i) He inherits plot of land since 1990.

(ii) For construction of residential house, he borrowed from State Bank of India on 14-2-2011.

(iii) He started construction of house property on 15-5-2011.

(iv) The construction of house property was completed on 10-5-2016.

(v) This house property was self-occupied during previous year 2016-17.

(vi) Interest payable to SBI for the financial year 2016-17 was Rs.2,30,000.

(vii) Municipal tax for the financial year 2016-17 was Rs. 1200

Find out income under the head house property in the hands of Mr. Gajanan.

Solution

Considering the above, the computation of income under the head house property in case of Mr. Gajanan for the financial year 2016-17 is as under:

Particulars	**Rs.**
Gross Annual Value	Nil
Less: Municipal Taxes paid during the previous year	Nil
Net Annual Value	Nil
Less: 30% of Net Annual Value	Nil
Less: Interest on borrowed capital –section 24(b)	(30,000)
Income under the head house property	(30,000)

Remark:

Apparently, it seems that Mr. Gajanan has completed construction within 5 years. However, for the purpose of section 24(b), one of the conditions to claim higher limit of Rs.2,00,000 is that construction shall be completed **within 5 years from the end of financial in which capital was borrowed**.(Readers must note that it is not from the date of commencement of construction) In the given case, the amount was borrowed on 14-2-2011 therefore construction should have been completed on or before 31-3-2016.

Readers Note:

Situation 3 :- When the property is not occupied during the whole previous year due to employment, business or profession carried on at some other place:

When the property is not occupied by the individual during the whole previous year due to employment, business or profession carried on at some other place then computation under this head shall be done as if it is self-occupied property (as discussed in Situation 2) provided all the following conditions are satisfied:

(a) Concerned property is not let out during the previous year.

(b) He has to reside at that other place in property not owned by him.

(c) No other benefit had been derived from the concerned property.

Situation 4 :- When Property is let out for some period and self-occupied for remaining period during the previous year:

For this situation, net income under the head "house property" shall be computed as if the property were let out throughout the previous year (as discussed in Situation 1).

Situation 5 :- House Property consists of two independent units of which one is let out and the other is self-occupied.

For this situation, net income under the head "house property" shall be computed as under:-

(a) For Let out Unit : - As discussed in Situation 1

(b) For Self-occupied Unit :- As discussed in Situation 2

Situation 6 :- House Property consists of three independent units of which first one is let out, second one is self occupied and last one is used for the purpose of business

For this situation, net income under the head "house property" shall be computed as under:-

(a) For Let out Unit : - As discussed in Situation 1

(b) For Self-occupied Unit :- As discussed in Situation 2

(c) For Business Unit:- As this unit is used for the purpose of business, it is outside the purview of head " Income from house property".

However for the business unit, assessee can claim following deductions under the head ''Profit & gain from business & profession''

(a) Repairs & Maintenance

(b) Insurance

(c) Depreciation

(d) Municipal tax –Allowed as deduction if it is deposited on or before due date of filing return u/s 139(1)- Section-43B.

Situation 7 :- When assessee owns more than one residential house property and all are reserved for self-occupation.

For this situation, at the option of assessee, one house property is to be selected as self occupied and other house properties shall be deemed to be let out.

The one house which has been selected as self-occupied, computation shall be done as per Situation 2.

While for deemed to be let out properties, computation shall be done as per Situation 1 – For deemed to be let out properties, Gross Annual Value shall be Expected Rent.

Situation 8 :- When house property is held in stock in trade [Section 23(5)]

Where the property consisting of any building or land appurtenant thereto is held as stock-in-trade

and

the property or any part of the property is not let during the whole or any part of the previous year,

the annual value of such property or part of the property,

for the period up to one year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority,

shall be taken to be nil.

Situation 9 :- When house property is owned by more than one owner [Co-owner]

If a house property is owned by two or more persons, then such persons are known as co-owners. Tax treatment of such property is given under section 26. Section 26 is applicable if the following conditions are satisfied –

(a) The property must consist of building or building and land appurtenant thereto
(b) It is owned or deemed to be owned by two or more persons.
(c) The respective shares of the co-owners are definite and ascertainable.

If above conditions are satisfied, then computation shall be done, as if each co-owner is the complete owner of his respective share in the house property.

4.8 TAX TREATMENT WHEN ASSESSEE RECOVERS RENT FOR THE PROPERTY AS WELL AS CHARGES FOR SERVICES RENDERED TO THE TENANT

Sometimes, owner of the property, apart from recovering rent of the building, also recovers amount towards charges for use of electricity, water, lift, providing security etc. The amount so recovered is known as composite rent. The tax treatment of such composite rent is given as under:-

(1) **Step 1:** Split up composite rent into the amount attributable to the use of property and amount attributable to the use of electricity, water, lift etc.
(2) **Step 2:** Amount attributable to the use of property shall be assessed under the head house property
(3) **Step 3:** Amount attributable to use of electicity, water, lift etc shall be taxed under the head “Profits and gains of business or profession” or under the head “Income from other sources”.

Illustrations

(1) Mr. Jayesh owns a property and given the same on rent to Mr. Rakesh. Mr. Rakesh pays Rs. 1,50,000 p.a. as rent of the property and Rs. 30,000 for different services like lift, security, air-conditioning, etc. In this case, Rs. 1,50,000 shall be taxed under the head “house property” while Rs. 30,000 shall be taxed under the head Profits and gains from business or profession or Income from other sources.

(2) Mr. Ashish owns a property and given the same on rent to Mr. Naimesh. Mr. Naimesh pays Rs.2,00,000 p.a. as rent of the building as well as the charges for electricity, security, water, etc. In this case, one has to split up ***compulsorily,*** the annual payment of Rs.2,00,000 into rent of .the building and charges for different services. The amount, which is attributable to the use of the house property, is to be taxed under the head "Income from house property". While, the amount, which relates to the charges towards electricity, security, water etc. is taxable either as business income or as income from other sources.

4.9 TAX TREATMENT WHEN ASSESSEE LETS OUT BUILDING WITH OTHER ASSETS LIKE PLANT AND MACHINERY, FURNITURE ETC

(a) here letting of plant, machinery and furniture alongwith building and letting is inseparable –

Meaning of inseparable letting: It means letting of one is not acceptable without letting of other. Sometimes, letting of one is not possible without another is called inseparable letting.

If letting is inseparable, then such inomce shall be taxed either under the head “Profits and gains from business or profession” or under the head “Income from other sources”.

Therefore, once letting is inseparable, nothing shall be taxed under the head “house property”. This rule is applicable even if amount of rent for two lettings has been fixed separately.

Illustration

Mr. Paresh owns house property. He also owns some movable furniture. Mr. Vimal is interested to take house property on rent. On the other hand, Mr. Paresh is interested to let the property alongwith furniture. Mr. Vimal agreed for both and further agreed to pay Rs. 5,000 p.m. for use of furniture and Rs. 15,000 p.m. for use of house property. Then, in this case, letting is inseparable, hence, entire rent income shall be taxed under the head “Profits and gains from business or profession” or under the head “Income from other sources”. This rule is applicable even if amount of rent for building and furniture has been fixed separately.

(b) Where letting of plant, machinery and furniture alongwith building and letting is separable–

Meaning of separable letting: It means letting of one is acceptable without letting of other.

If letting is separable, then income from letting out of building is taxable under the head "Income from house property" and income from letting out of other assets is taxable either as business income or income from other sources.

This rule is applicable even if the assessee receives composite rent from his tenant for two lettings.

Illustration

Mr. Nirav gets Rs. 25,000 per month as rent from Mr. Pranav for letting out of a building and furniture. The two lettings are separable in the sense that Mr. Pranav was given an option to take on rent either the building at Rs. 20,000 or the furniture at Rs. 5,000 or both. Mr. Pranav agreed for both. Then, the rent of the building is taxable under the head "Income from house property" and the rent of furniture is taxable either as business income or income from other sources.

4.10 AMOUNTS NOT DEDUCTIBLE FROM INCOME FROM HOUSE PROPERTY

Section:- 25

Any interest chargeable under this Act which is payable outside India, on which tax has not been paid or deducted under Chapter XVII-B, shall not be deducted in computing the income chargeable under the head "Income from house property".

4.11 TAXABILITY OF UNREALISED RENT AND ARREARS OF RENT.

Section:- 25A

At present, section 25AA deals with taxability of unrealised rent when realised subsequently and section 25B deals with the tax treatment of arrears of rent received.

These two provisions are now merged in new section 25A. The summary of new section 25A is as under:

Sr. No.	Taxability of Arrears of Rent or Unrealised Rent
(i)	Taxable in the year of receipt or
(ii)	Deduction@30% of rent received
(iii)	Taxable even if assessee is not the owner of the property in the financial year of receipt

Practical 3

Mr. Parmanand provides following information:

(a) In July, 2017, he recovered unrealized rent of Rs. 50,000 (which was reduced from Gross Annual Value earlier) from Mr. Saif (tenant).

(b) In October, 2017, he received arrears of rent (which was not taxed earlier) of Rs. 70,000 from State Bank of India (tenant).

Discuss taxability of above receipts in the hands of Mr. Parmanand under following alternatives:

(1) Mr. Parmanand has already sold out the captioned house property on 10-2-2017

(2) Mr. Parmanand continued to own the house property in previous year 2017-18.

Solution

Computation of income from house property of Mr. Parmanand for A.Y.2017-18

Particulars		Rs.
(i)	Unrealised rent recovered from Mr. Saif	50,000
(ii)	Arrears of rent received from SBI	70,000
		1,20,000
Less: Deduction@30%		(36,000)
Income from house property		**84,000**

Reader's Note:

4.12 SOME MISCELLANEOUS ISSUES UNDER THE HEAD "INCOME FROM HOUSE PROPERTY"

(a) Property held as stock-in-trade

As a specific head of charge is provided for income from house property, annual value of house property, therefore, can be brought to tax under this head only. It will remain so even if the property is held by the assessee as stock-in-trade of a business.

(b) House property in a foreign country

Tax incidence is attracted in the hands of individual under section 22 in respect of a house property situated abroad in following cases:

(1) If individual is resident and ordinarily resident or

(2) Rent income is received in India

Therefore, in above case, annual value will be computed as if property is situated in India.

(c) When income from property is totally exempt?

In the following cases, income from property is not charged to tax:

(1) income from farm house [sec. 10(1)] ;

(2) annual value of any one palace of an ex-ruler [sec. 10(19A)];

(3) property income of a local authority [sec. 10(20)];

(4) property income of an approved scientific research association [sec. 10(21)];

(5) property income of an educational institution and hospital [sec. 10(23C)j;

(6) property income of a trade union [sec. 10(24)];

(7) house property held for charitable purposes [sec. 11];

(8) property income of a political party [sec. 13A].

4.13 CRITICAL JUDICIAL RULINGS IN QUESTION – ANSWER FORMAT

Case Study 1

Chennai Properties and Investments Ltd. was incorporated under the Companies Act, 1956. Its main objective, as stated in the memorandum of association, is to acquire properties in the city of Madras and let out those properties. The company had rented out such properties and the rental income was shown as its business income in the return filed by the assessee.

The Assessing Officer, however, assessed the rental income under the head "Income from house property". Whether the action of assessing officer is justified?

Solution

Supreme Court in case of Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673 (SC) observed that the High Court had pronounced its ruling (in favour of Department) on the basis of the decision of the Apex Court in East India Housing and Land Development Trust Ltd.'s case, wherein the letting out of property was not the object of the company at all. Therefore, in that case, the Apex Court was of the opinion that the character of the income which was from house property had not changed merely because it was received by the company formed with the object of developing and setting up properties.

The Supreme Court further observed the law laid down authoritatively and succinctly by it in Karanpura Development Co. Ltd. v. CIT [1962] 44 ITR 362. In that case, the assessee company was formed with the object of, inter alia, acquiring and disposing of the underground coal mining rights in certain coal fields and it had restricted its activities to acquiring coal mining leases over large areas, developing them as coal fields and then sub-leasing them to collieries and other companies. Thus, in that case, the leasing out of the coal fields to the collieries and other companies was the business of the assessee. The income which was received from letting out of those mining leases was shown as business income. Department took the position that the same was to be treated as income from the house property. Thus, in similar circumstances, an identical issue arose before the Apex Court.

The Apex Court pointed out that the deciding factor as to the head under which the income was to be assessed is not the ownership of land or leases but the nature of the activity of the assessee and the nature of the operations in relation to them.

It was highlighted and stressed that the objects of the company must also be kept in view to interpret the activities. In support of the aforesaid proposition, a number of judgments of other jurisdictions, i.e., Privy Council, House of Lords in England and the US Courts were taken note of.

After applying the aforesaid principle to the facts, the Apex Court had arrived at the conclusion that such income had to be treated as income from business and not as income from house property.

As a result, the action of assessing officer taxing income under the head "house property" is not justified.

Reader's Note:

Case Study 2

Whether the rental income derived from the unsold flats which are forming part of stock-in-trade would be taxable under the head 'Profits and gains from business or profession'?

Solution

In the case of New Delhi Hotels Ltd. v. ACIT (2014) 360 ITR 187, the Delhi High Court followed its own decision in the case of CIT vs. Discovery Estates Pvt. Ltd/CIT vs. Discovery Holding Pvt. Ltd., wherein it was held in the case of rental income derived from unsold flats which were shown as stock-in trade in the books of the assessee should be assessed under the head "Income from house property" and not under the head "Profits and gains from business and profession"

However, assessee can take advantage of newly inserted sub-section (5) of Section 23 if conditions mentioned therein are satisfied.

Reader's Note:

Case Study 3

NDR warehousing Private Ltd is engaged in the business of warehousing, handling and transport business claimed income from letting out of buildings and godowns as business income. The Assessing Officer assessed such income as "Income from house property". Whether action of assessing officer is justified in the eyes of law?

Solution

Madras High Court in case of CIT v. NDR Warehousing P Ltd (2015) 372 ITR 690 (Mad) concurred with findings of lower appellate authorities, namely CIT (A) and ITAT and **held that** the income earned by the assessee from letting out of godowns and provision of warehousing services is chargeable to tax under the head "Profits and gains of business or profession" and not under the head "Income from house property"

The Commissioner (Appeals) observed that the assessee's activity was not merely letting out of warehouses but storage of goods with provision of several auxiliary services such as pest control, rodent control and fumigation service to prevent the goods stored from being affected by vagaries of moisture and temperature. Further, service of security and protection was also provided to the goods

stored. There is, therefore, no dispute that the assessee carries on the activity in an organised manner. These activities are more than mere letting out of the godown for tenancy.

The Tribunal noted that the objects clause of the memorandum of association of the company clearly shows that the assessee-company was incorporated with the object of carrying on the business of warehousing and letting/renting of godowns and providing facilities for storage of articles or things and descriptions whatsoever. The profit and loss account of the assessee company shows that its main source of income is storage charges and maintenance or user charges. Even substantial part of the expenses also relate to the salaries of employees engaged in the maintenance and upkeep of the godowns and warehouses. As a result, action of assessing officer is not justified.

Reader's Note:

Case Study 4

Shri Hariprasad alongwith family members occupied the house property owned by HUF and claimed the benefit of self-occupation of a house property under section 23(2). [GAV = NIL]. However, the Assessing Officer did not accept the said claim and denied the benefit of self-occupation of house property to the HUF contending that such benefit is available only to the owner who can reside in his own residence i.e., only an individual assessee, who is a natural person, and not to an imaginary assessable entity being HUF or a firm, etc. Whether action of the assessing officer denying benefit of concessional GAV is correct?

Solution

Gujarat High Court in case of CIT v. Hariprasad Bhojnagarwala (2012) 342 ITR 69 (Guj.) (Full Bench) observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an individual owner who can actually occupy the house.

However, the HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons. The said family can reside in the house, which belongs to the HUF. Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity.

The High Court also observed that since singular includes plural, the word "owner" would include "owners" and the words "his own" used in section 23(2) would include "their own".

Therefore, the Court held that the HUF is entitled to claim benefit of self-occupation of house property u/s 23(2).

Considering the above, the action of the assessing officer denying benefit of concessional GAV is not in accordance with law.

Reader's Note:

Case Study 5

Asian Hotels Ltd. received interest-free deposit in respect of shops given on rent. The Assessing Officer added to the assessee's income notional interest on the interest free deposit at the rate of 18 per cent simple interest per annum on the ground that by accepting the interest free deposit, a benefit had accrued to the assessee which was chargeable to tax under section 28(iv) or alternatively, under the head income from house property. Comment on the action of assessing officer.

Solution

Facts of the case: The assessee had received interest-free deposit in respect of shops given on rent. The Assessing Officer added to the assessee's income notional interest on the interest free deposit at the rate of 18 per cent simple interest per annum on the ground that by accepting the interest free deposit, a benefit had accrued to the assessee which was chargeable to tax under section 28(iv).

Delhi High Court in case of CIT v. Asian Hotels Ltd. (2010) 323 ITR 490 observed that section 28(iv) is concerned with business income and brings to tax the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. Section 28(iv) can be invoked only where the benefit or amenity or perquisite is otherwise than by way of cash. Hence, section 28(iv) is not applicable.

Section 23(1) deals with the determination of the expected rent of a let out property for computing the income from house property. This contemplates the possible rent that the property might fetch and certainly not the interest on fixed deposit that may be placed by the tenant with the landlord in connection with the letting out of such property.

Thus, the notional interest is neither assessable as business income nor as income from house property. The action of assessing officer is, therefore, not in accordance with law.

Reader's Note:

5 – PROFITS AND GAINS FROM BUSINESS OR PROFESSION

UNIT A – TAXABILITY AND ALLOWANCES

5.1 CHARGEABILITY UNDER THIS HEAD

Section:- 28

(1)	Section	Chargeable Income
	28(i)	Profits and gains of any business or profession which was carried on by the assessee at any time during the previous year.

(2)	Section	Chargeable Income
	28(ii)	Compensation or other payment received by, - (a) any person managing the whole or substantially the whole of 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 person managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the term and conditions relating thereto; (c) any person, 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; (d) any person, for or in connection with the vesting in the Government or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business.

Practical 1

Mr. Dave is holding agency of Ambuja Cement Limited in South Gujarat since 2000-01. During the relevant previous year, as a part of marketing strategy, Ambuja Cement Limited terminated the agency of Mr. Dave and paid Rs. 10,00,000 as compensation. Mr. Dave claims that Rs.10,00,000 shall not be taxed since it is a capital receipt, being a compensation for the loss of source of income. Verify the contention of Mr. Dave.

Solution

Considering point no. (c) above, such compensation shall be taxed under the head PGBP even though it is a capital receipt. Therefore, contention of Mr. Dave is not tenable.

Reader's Note:

(3)	Section	Chargeable Income
	28(iii)	Income received by a trade or professional or similar association from specific services rendered to members

SECTION 44A

(4)

Section	Chargeable Income
28(iiia)	Profit on sale of import license
28(iiib)	Cash assistance against exports under any scheme of Government of India
28(iiic)	Duty drawback against exports under the Drawback Rules

(5)

Section	Chargeable Income
28(iv)	Benefit or perquisite arising from exercise of business or profession

Practical 2

Mr. Sunil is a proprietor of Anant Pharma, a distributor of Zydus Pharma Limited. Zydus Pharma Limited had given free foreign trip to the family of Mr. Sunil considering the business performance of Anant Pharma. Discuss taxability, if any, in the hands of Mr. Sunil assuming that costing of similar foreign trip is Rs. 2,80,000.

Solution

As per section 28(iv), any benefit or perquisite arising from exercise of business or profession shall be taxed under the head "PGBP". In the present case, Mr. Sunil benefited by Rs. 2,80,000 because of good business performance of Anant Pharma. Therefore, Rs. 2,80,000 shall be taxed in the hands of Mr. Sunil under head "PGBP".

Reader's Note:

(6)

Section	Chargeable Income
28(v)	Interest, salary, commission or remuneration received by a partner from firm to the extent firm allowed deduction for the same.

(7)

Section	Chargeable Income
28(va)	Sum received or receivable, in cash or kind, under an agreement for- (a) not carrying out any activity in relation to business or profession or (b) not to share any known-how, patent copyright, trademark, 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. However, following shall not be charged under this head: (1) any sum received on account of transfer of the right to manufacture, produce or process any article or thing which is chargeable as capital gains; (2) any sum received on account of transfer of a right to carry on any business or profession, which is chargeable as capital gains; (3) any sum received as compensation from the multilateral fund of the Montreal Protocol under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Practical 3

ABC Contractors Ltd. has paid Rs. 10,00,000 to PQR Contractors Ltd. for not participating in a particular Government tender. Discuss taxability of Rs. 10,00,000 in the hands of PQR Contractors Ltd.

Solution

As per section 28(va), any sum received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to business shall be treated as income and the same shall be charged to tax under the head "PGBP".

Therefore, amount of Rs.10,00,000 received by PQR Contractor Ltd. for not participating in a particular Government tender is an income and the same shall be charged to tax in its hands under the head "PGBP".

Reader's Note:

(8)

Section	Chargeable Income
28(vi)	Any sum received under Keyman insurance policy

SECTION 17(3) AND SECTION 56(2): For detailed discussion: Refer Module II – Chapter 7 - Income from other Sources

(9)

Section	Chargeable Income
28(vii)	any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

(10)

Explanation to section 28	Chargeable Income
Explanation 2	Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business shall be deemed to be distinct and separate from any other business.

5.2 INCOME FROM PGBP, HOW COMPUTED?

Section:- 29

The income under this head shall be computed in accordance with the provisions contained in sections 30 to 43D of the Act.

5.3 THE MEANING OF WORD "PAID"

Sections:- 43(2)

Section 43(2) defines the word "paid" to mean actually paid or incurred according to the method of accounting adopted for this head i.e. cash system or mercantile system.

However, in case of following sections, deduction is allowed on "Actual Payment" basis irrespective of method of accounting followed by taxpayer:

Section No.	Particulars
35ABB	
35ABA	
35DDA	
43A	
43B	

5.4 RENT, RATES, TAXES, REPAIRS AND INSURANCE OF BUILDINGS

Section:- 30

(1) General Condition

The premise shall be used for the purpose of business or profession.

(2) Deduction

The following expenses are allowed:

(a) As a tenant,
  (i) rent paid for such premises
  (ii) amount paid on account of repairs, if he has undertaken to bear the cost of repairs

(b) Otherwise than as a tenant- amount paid by him on account of **current repairs**

Note: For removal of doubts, cost of repairs/ current repairs (mentioned above) shall not include any expenditure in nature of capital expenditure.

(c) Sum paid on account of land revenue or local rates or municipal taxes

(d) Premium paid in respect of insurance against risk of damage or destruction of premises

5.5 REPAIRS AND INSURANCE OF MACHINERY, PLANT AND FURNITURE.

Section:- 31

(A) Condition

The machinery, plant or furniture shall be used for the purpose of business or profession

(B) Deduction

The following deductions shall be allowed:

(i) Amount paid on account of **current repairs** but it shall not include any expenditure in the nature of capital expenditure.

(ii) Amount of premium paid in respect of insurance.

5.6 DEPRECIATION

Section:- 32

Refer Module III - Chapter 45 - Depreciation

5.7 TEA OR COFFEE OR RUBBER DEVELOPMENT ACCOUNT

Section:- 33AB

(A) Who can claim?

All assesses who carry on the business of growing and manufacturing tea or coffee or rubber in India.

(B) Conditions:

(a) The assessee shall deposit the amount with NABARD / Tea or Coffee or Rubber Development Account within 6 months from the end of the relevant previous year or before the due date of filing return under section 139(1), whichever is earlier.

(b) The accounts of the assessee of this business shall be audited by a chartered accountant and audit report shall be furnished in a prescribed form along with his return of income.

(C) Quantum of deduction:

Least of the following is deductible:

(a) Amount deposited; or

(b) 40% of profits or gains of business or profession before making any deduction under this section and u/s. 72 (i.e. before claiming set off).

(D) Where any deduction is allowed under this section, no deduction shall be allowed in respect of such amount in any other previous year.

(E) Deduction under this section shall not be allowed in computation of income of a partner of a firm or member of AOP or BOI.

(F) Manner of utilisation of deposit:

The amount kept in the deposit will not be allowed to be withdrawn except for the purposes specified in the scheme.

(G) Ineligible Assets:

(a) Any machinery or plant installed in office or residential accommodation or guesthouse.

(b) Any office appliances other than computer

(c) Any machinery or plant entitled for 100% depreciation or deduction under the Act.

(d) Any new plant or machinery to be installed in an industrial undertaking manufacturing any article specified in Eleventh Schedule.

(H) Taxability treatment of deposits in case of closure of business:

Event of closure	Taxability
(i) **Closure of business;** (ii) **Dissolution of firm**	Amount withdrawn shall be deemed to be the profits and gains of the previous year in which it is withdrawn (i.e. it is taxable under the head "PGBP")
(iii) **Death of assessee;** (iv) **Partition of HUF** (v) **Liquidation of Company**	Amount withdrawn shall not be taxable.

(I) Subsequent withdrawal of benefit claimed under section 33AB:

(a) Non-utilisation / mis-utilisation:- The amount withdrawn during any previous year is not utilised within the previous year or utilised for a purpose other than those specified in the scheme, then it shall treated as the income and charged to tax in that previous year.

(b) Subsequent sale of asset: Where the asset acquired in accordance with the scheme is transferred or sold within 8 years from the end of the previous year in which it was acquired, the portion of the deduction allowed shall be treated as income of the previous year in which the asset is sold or otherwise transferred.

The above provision relating to subsequent sale of asset shall not apply in the following situations:

(i) Transfer to Government or local authority or Corporation or Government Company

(ii) Succession of firm by a company

Practical 4

X Ltd., is a company engaged in the business of growing, manufacturing and selling of tea. It provides following information for the accounting year ended **31st March, 2017.**

(i) Composite business profits, before an adjustment u/s 33AB of the Income-tax Act, were Rs.60 lakhs.

(ii) In the year, it deposited Rs.20 lakhs with NABARD. The company has a business loss of Rs.10 lakhs brought forward from the previous year.

Indicate clearly the tax consequences of the above transaction and the total income for the relevant year.

Solution

Before we refer solution, let's understand following important point:

Computation of agricultural income of an assessee who grows and manufactures tea, coffee or rubber.

First of all, we have to determine income under the head "Profit and Gains of Business" (POB) as if entire activity is chargeable to tax and

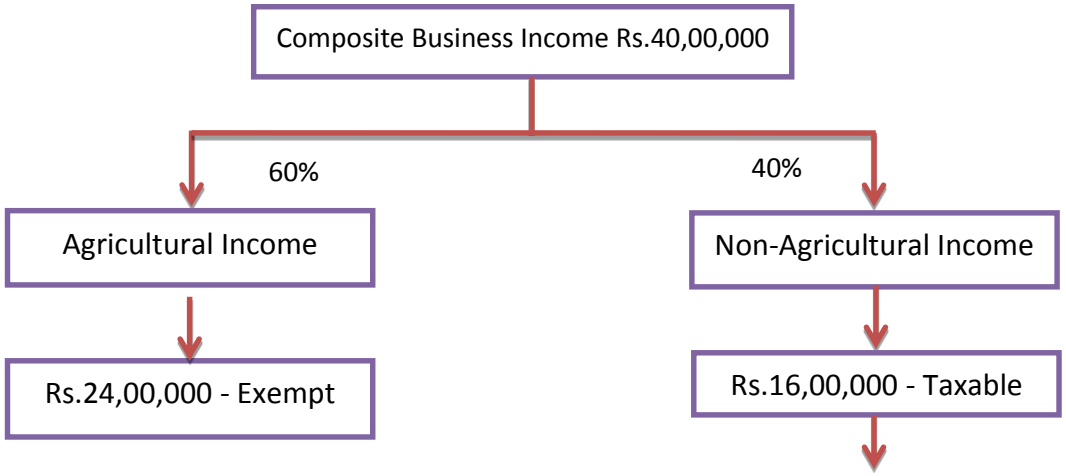
thereafter such income shall be bifurcated in the following manner:

Nature of Business	Agricultural Income	Non-Agricultural Income
Sale of centrifuged latex or cenex manufactured from rubber	65% of POB	35% of POB
Sale of coffee grown, cured, roasted and grounded by seller in India	60% of POB	40% of POB
Sale of coffee grown and cured by seller in India	75% of POB	25% of POB
Growing and manufacturing tea	60% of POB	40% of POB

P.Y. 2016-17

A.Y. 2017-18

Particulars	Rs.
Business Income before deduction u/s 33AB	60,00,000
Less: Deduction u/s 33AB [W.N.1]	(20,00,000)
Composite Business Income under the head 'PGBP'	40,00,000



Particulars	Rs.
Income	16,00,000
Less: B/f business loss	(10,00,000)
Taxable Income	**6,00,000**

Working Note 1:

Deduction u/s 33AB is

(a) Amount deposited : Rs. 20,00,000

(b) 40% of Rs.60,00,000 : Rs. 24,00,000

Whichever is lower.

Reader's Note:

Practical 5

Continuing **Practical 4**, the company withdrew in **February, 2019** Rs.20 lakhs from the deposit account to buy a non-depreciable asset for Rs.18 lakhs and could not use the balance before the end of the accounting year. The withdrawal and the purchase were under a scheme approved by the Tea Board. Indicate clearly the tax consequences of the above transaction and the total income for the relevant year.

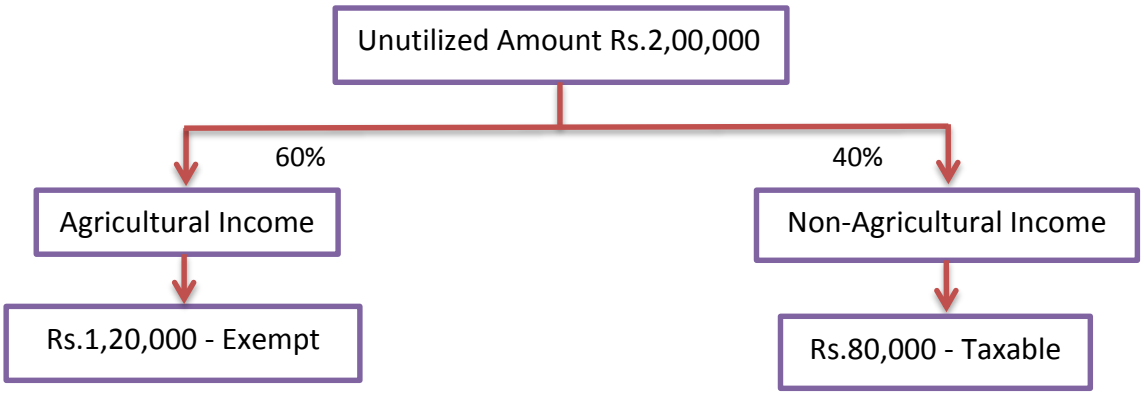
Solution

P.Y. 2018-19

A.Y. 2019-20

Particulars	Rs.
Amount withdrawn from a special account during the previous year 2018-19	20,00,000
Less: Amount utilised during the same previous year (i.e., 2018-19)	(18,00,000)
Amount unutilized	2,00,000

Tax Treatment of Unutilized Amount



Reader's Note:

Practical 6

Continuing **Practical 4 and Practical 5**, the non-depreciable asset was sold in **November, 2021** for Rs.29 lakhs.

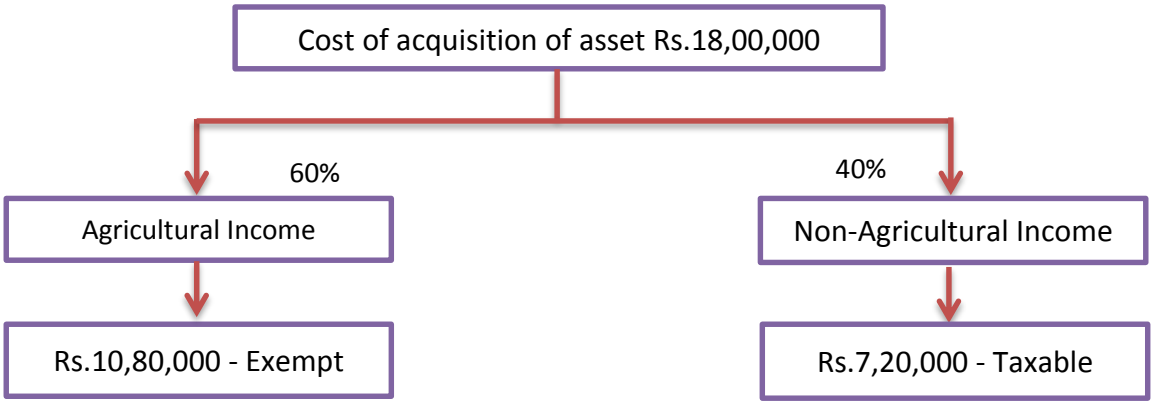
Indicate clearly the tax consequences of the above transactions and the total income for the relevant years.

Solution

P.Y. 2021-22

A.Y. 2022-23

(1) Tax Treatment under the head 'Profit and Gains from Business or Profession'



(2) Tax Treatment under the head 'Capital Gains'

Period of holding: February, 2019 to November, 2021 (i.e., not exceeding 36 months)

Nature of Asset: Short term capital asset

Computation of Capital Gain

Particulars	Rs.
Full value of consideration	29,00,000
Less: Cost of acquisition	(18,00,000)
Short Term Capital Gain	11,00,000

Reader's Note:

5.8 SITE RESTORATION FUND ACCOUNT

Section:- 33ABA

(1) Who can claim?

An assessee carrying on business, consisting of prospecting or extraction or production of petroleum or natural gas or both, in India, in respect of which the Central Government has entered into an agreement with the assessee.

(2) Conditions

(a) The assessee shall deposit the amount with SBI or Site Restoration Fund Account before the end of the previous year.

(b) The accounts of the assessee of this business shall be audited by a chartered accountant and audit report shall be furnished in a prescribed form along with his return of income.

(3) Quantum of Deduction

Least of the following is deductible-

(a) Amount deposited or

(b) 20% of Current year profit of such business before making any deduction under this section and u/s. 72.

(4) Provisions relating to utilization of deposit, Ineligible Assets, Withdrawal of Exemption are at par with Sec. 33AB.

(5) Consequences in the case of closure of business

Where any amount is withdrawn on closure of business, then amount so withdrawn less any amount payable to Central Government by way of profit as provided in agreement refer to in Sec. 42 shall be deemed to be the business income of that year.

5.9 EXPENDITURE ON SCIENTIFIC RESEARCH

Section:- 35

(A) Deduction of expenditure on in house research by any assesse [Section 35(1)(i) and (2)]

The following expenditure **incurred** by the assessee on scientific research in relation to the assessee's business shall be allowed as deduction:

(i) Current year revenue expenditure on scientific research.

(ii) Current year capital expenditure on scientific research.

(iii) Prior period revenue expenditure or capital expenditure incurred during 3 years immediately preceding the date of commencement of business will be allowed as deduction in the previous year in which the assessee commences the business.

(iv) Revenue expenditure of a prior period shall be the payment of salary (excluding perquisites) to research personnel and material cost used for research.

- Prior period revenue expenditure shall be deductible to the extent certified by prescribed authority.
- But prior period capital expenditure are not required to be certified by prescribed authority.

(v) The expenditure on acquisition of land will not be allowed as a deduction.

(vi) The assessee is not entitled to claim any depreciation on the capital expenditure which has been allowed as deduction u/s. 35(2).

(B) Deduction for expenditure on in house research by companies in special business [Section 35(2AB)]

(i) In case of a company engaged in the business of bio-technology or any business of manufacture or production of any article or thing except those specified in the Eleventh Schedule, an amount equal 200% of the expenditure incurred on scientific research shall be allowed as deduction.

(ii) The cost of any land or building shall not be allowed as a deduction.

(iii) Once deduction is claimed under this section, then same expenditure shall not be allowed as deduction under any other provision of Income Tax Act.

(iv) For the purpose of claiming deduction under this section, company shall enter into an agreement with the prescribed authority for co-operation in such research and development facility and fulfils such conditions with regard to maintenance of accounts and audit thereof and furnishing of reports in such manner as may be prescribed.

(v) The prescribed authority shall submit its report in relation to the approval of the said facility to the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General in such form and within such time as may be prescribed.

Comparison between {Section 35(1) (i) /(2)} and {Section 35(2AB)}

Section No.	Who can Claim?	Nature of Expenditure	Percentage of Deduction	Whether Prior Period covered?	Restriction
35(1)/(2)	Any assessee	Revenue/Capital	100%	Yes	Land
35(2AB)	Company in Special Business	Capital as well as Revenue	200%	No	Land & Building

Section 35(1) and 35(2) are applicable to any assessee including company in special business also. Therefore, company in special business can claim-

(a) deduction of building at 100 %.

(b) deduction of prior period capital as well as revenue expenditure at 100%.

Practical 7

An assessee commenced production of chemicals on **1st November, 2017**. It has made the following expenditure on scientific research before commencement of production:

(a) Salary to research personnel and the cost of research material during the 12 months ending on **31st October, 2014**: Rs.8,30,000.

(b) Salary to research personnel from **1st November, 2014 to 31st October, 2017**: Rs.24,50,000 (out of which amount certified by the prescribed authority was Rs.18,12,000)

(c) Expenditure on providing rent – free flats to research personnel, from **1st November, 2014 to 31st October, 2017**: Rs.1,80,000.

(d) Cost of research material from **1st November, 2014 to 31st October, 2017**: Rs.18,75,200 (out of which amount certified by the prescribed authority was Rs.17,44,800).

(e) Capital expenditure on scientific research upto **31st October, 2014** –

(i) Payment towards purchase of land : Rs. 50,00,000.

(ii) Payment towards construction of laboratory building: Rs.12,00,000.

(iii) Purchase of plant and machinery to be used in laboratory: Rs. 17,00,000.

(f) Capital expenditure on scientific research between **1st November, 2014 to 31st October, 2017** - not certified by the prescribed authority

(i) Payment towards purchase of land : Rs. 20,00,000.

(ii) Payment towards construction of laboratory building: Rs.6,00,000.

(iii) Purchase of plant and machinery to be used in laboratory: Rs. 28,00,000.

(g) Revenue expenditure on scientific research incurred after commencement of business: Rs. 20,00,000.

Determine the amount of deduction available under section 35 under following alternatives assuming that the scientific research is related to the business of the assessee :

Alternative (1) : An assessee is a partnership firm.

Alternative (2): An assessee is an Indian company engaged in special business.

Solution

Alternative 1: An assessee is a partnership firm

Statement showing deduction under section 35

Particulars	Rs.
a. Expenditure incurred till **October 2014**-not deductible as it is incurred beyond 3 years.	Not Deductible
b. Prior period revenue expenditure incurred during 3 years immediately preceding **01.11.2017** to the extent certified by prescribed authority.	18,12,000
c. Expenditure on providing perquisites (i.e, rent – free flats) to research personnel	Not Deductible

d. Expenditure on research material to the extent certified by prescribed authority.	17,44,800
e. Capital expenditure incurred till **October 2014** –not deductible as it is incurred beyond 3 years.	Not Deductible
f. Capital expenditure incurred during 3 years immediately preceding **01.11.2017**. (Certification of prescribed authority not required)	
(i) Purchase of land	Not Deductible
(ii) Construction Cost	6,00,000
(iii) Cost of plant and machinery	28,00,000
g. Revenue expenditure on research after commencement of business.	20,00,000
Total deduction under section 35	**89,56,800**

Alternative 2: An assessee is an Indian company engaged in special business

Statement showing deduction under section 35

Particulars	**Rs.**
a. Expenditure incurred till **October 2014**-not deductible as it is incurred beyond 3 years.	Not Deductible
b. Prior period revenue expenditure incurred during 3 years immediately preceding **01.11.2017** to the extent certified by prescribed authority. (at 100%)	18,12,000
c. Expenditure on providing perquisites (i.e, rent – free flats) to research personnel	Not Deductible
d. Expenditure on research material to the extent certified by prescribed authority. (at 100%)	17,44,800
e. Capital expenditure incurred till **October 2014** –not deductible as it is incurred beyond 3 years.	Not Deductible
f. Capital expenditure incurred during 3 years immediately preceding **01.11.2017**. (Certification of prescribed authority not required)	
(i) Purchase of land	Not Deductible
(ii) Construction Cost (at 100%)	6,00,000
(iii) Cost of plant and machinery (at 100%)	28,00,000
g. Revenue expenditure on research after commencement of business. (at 200%)	40,00,000
Total deduction under section 35	**109,56,800**

Reader's Note:

(C) Contribution made to outsiders [Section 35(1)(ii)/(iii)/(iiia) and Section 35(2AA)]

Where assessee makes contributions to other institutions for research purpose, a weighted deduction is allowed, as follows-

Section No.	To whom contribution can be given?	To be utilized for?	Weighted deduction from the A.Y. 2018-19 to 2020-21	Weighted deduction A.Y. 2021-22 onwards
35 (1) (ii)	An approved association or an approved university, college or other institution	Scientific research	150 % of contribution	100 % of contribution
35 (1) (iii)	An approved association or an approved university, college or other institution	Social science research or Statistical research	100 % of contribution	100 % of contribution
35 (2AA)	National Laboratory, University, IIT or specified person approved by prescribed authority	Scientific research	150% of Contribution	100% of Contribution
35(1)(iia)	Company registered in India having main object of scientific research and development provided such company is time being approved by the prescribed authority	Scientific research	100% of Contribution	100% of Contribution

Notes:

1. Above deduction can be claimed by any assessee even if research is not related to assessee's business.
2. Deduction in respect of above contribution made to above institutions shall not be denied merely on the ground that, subsequent to contribution made by assessee, the approval granted to these institutions have been withdrawn.

Practical 8

PQR private limited has shown a net profit of Rs. 32,88,000 after debiting following items:

1. Rs.1,00,000 paid to the Indian Agricultural Research Institute, New Delhi, being an approved scientific research institution under section 35(1)(ii) for the purpose of carrying out scientific research in natural science.
2. Rs.75,000 paid to the Indian Institute of Management, Ahmedabad being an approved institute under section 35(1)(iii), for the purpose of carrying out scientific research in social or statistical science.
3. Rs.51,000 paid to an approved National Laboratory for carrying out scientific research.
4. Rs. 11,000 paid to IIT for carrying out scientific research.
5. Rs. 30,000 paid to TATA Research Limited, an Indian company approved under section 35(1) (iia) for carrying out scientific research.

Find out income of PQR private limited under the head "PGBP".

Solution

	Particulars	Rs.
	Net Profit as per Profit & Loss account	**32,88,000**
Add:	Contribution to Indian Agricultural Research Institute, New Delhi	1,00,000
Less:	Contribution to Indian Agricultural Research Institute, New Delhi-Section 35(1)(ii) [150% of Rs.1,00,000]	(1,50,000)
Add:	Contribution to Indian Institute of Management, Ahmedabad	75,000
Less:	Contribution to Indian Institute of Management, Ahmedabad - Section 35(1)(iii) [100% of Rs.75,000]	(75,000)
Add:	Contribution to approved National Laboratory	51,000
Less:	Contribution to approved National Laboratory - Section 35(2AA) [150% of Rs.51,000]	(76,500)
Add:	Contribution to IIT	11,000
Less:	Contribution to IIT - Section 35(2AA) [150% of Rs.11,000]	(16,500)
Add:	Contribution to TATA Research Limited	30,000
Less:	Contribution to TATA Research Limited- Section 35(1) (iia) [100% of Rs.30,000]	(30,000)
	Business Profit	**32,07,000**

Reader's Note:

Practical 9

ABC Scientific Research (P) Ltd is a company registered in India and approved u/s 35(1)(iia) as well as eligible to claim deduction under section 35(2AB). During previous year it spent Rs. 3 crore on scientific research related to its business. Can it claim 200% of Rs.3 crore as deduction u/s 35(2AB)?

Solution

On close reading of the clarification given under Section 35(1)(iia), company approved for accepting contribution under section 35(1)(iia) cannot claim weighted deduction of 200 percent under section 35(2AB). Considering the same, ABC Scientific Research (P) Ltd. cannot claim weighted deduction under section 35(2AB).

However, the restriction is for section 35(2AB) and not for section 35(1) and 35(2). Therefore, it can claim deduction of Rs. 3 crore.

Reader's Note:

(D) Carry forward and set off of unabsorbed scientific research expenditure

It shall be given the same treatment as is given to the unabsorbed depreciation.

5.10 PROVISIONS FOR EXPENDITURE INCURRED FOR OBTAINING LICENSE TO OPERATE TELECOMMUNICATION SERVICES

Section:- 35ABB

(A) Conditions

(i) As per provisions of this section, deduction shall be allowed in respect of capital expenditure incurred for the purpose of acquiring any right to operate telecommunication services.

(ii) But for claiming deduction, the assessee must have made actual payment to obtain the license.

(iii) The assessee will get deduction in equal installments over the period starting from the previous year in which payment has been made and ending with the previous year in which license comes to an end.

However, if business is commenced after the payment for license has been made then deduction under this section shall be allowed over the period starting from the previous year in which business is commenced and ending with the previous year in which the license comes to an end.

(B) Consequences on transfer of license

(a) If entire license is transferred then following possibilities may arise:

- It may result in surplus then surplus to the extent deduction claimed in past shall be taxed under this section in the year of transfer.
- It may result in deficit then such deficit shall be allowed as deduction under this section in the year of transfer.

(b) If part of license is transferred then following possibilities may arise:

- It may result in surplus then surplus to the extent deduction claimed in past shall be taxed under this section in the year of transfer.
- If it does not result in surplus then balance amount of license shall be allowed as deduction under this section over the unexpired period of license.

(c) Once deduction is allowed under this section no depreciation can be claimed under section 32 of Income Tax Act, 1961.

Practical 10

X Ltd., a company providing telecommunication service, obtains a telecom licence on **April 20, 2017** for a period of 10 years. The licence fee was Rs. 18 lakh. Find out the amount of deduction under section 35ABB if-

(a) the entire amount is paid on **May 6, 2017**; or

(b) the entire amount is paid on **April 1, 2018**;

(c) the entire amount is paid in three equal instalments on **April 30, 2017, April 30, 2018 and April 30, 2019.**

Solution

(a) Deduction under section 35ABB starting from previous year **2017-18**

$= \frac{Rs.18,00,000}{10\ years}$ =Rs.1,80,000 for 10 years

(b) Deduction under section 35ABB starting from previous year **2018-19**

$= \frac{Rs.18,00,000}{9\ years}$ =Rs.2,00,000 for 9 years

(c) Computation of Deduction under section 35ABB

Particulars	Previous Years		
	2017-18 (Rs.)	2018-19 (Rs.)	2019-20 Onwards (Rs.)
First Instalment $\frac{Rs.6,00,000}{10\ years}$	60,000	60,000	60,000
Second Instalment $\frac{Rs.6,00,000}{9\ years}$	-	66,666	66,666
Third Instalment $\frac{Rs.6,00,000}{8\ years}$	-	-	75,000
TOTAL	60,000	1,26,666	2,01,666

Reader's Note:

Practical 11

Y Ltd., a company providing telecommunication services, acquires a telecom licence on **April 5, 2017** for a period of 15 years. The licence fees was Rs. 15 lakh which was paid on **May 6, 2017.** The licence then transferred by Y Ltd. on **December 20, 2019** for (a) Rs. 8,00,000 (b) Rs. 13,50,000 or (c) Rs. 15,10,000. Compute the amount chargeable to tax.

Solution

Deduction under section 35ABB starting from previous year **2017-18**

= $\frac{Rs.15,00,000}{15\ years}$ =Rs.1,00,000 for 15 years

Particulars	Rs.
Licence transferred on **20.12.2019 – P.Y.2019-20**	
Cost of Licence	15,00,000
Less: (1) Deduction for previous year **2017-18**	(1,00,000)
(2) Deduction for previous year **2018-19**	(1,00,000)
(3) Deduction for previous year **2019-20**	Nil
Balance as on date of sale	13,00,000

Computation of surplus / (Deficit) when license is transferred

Particulars	Option A	Option B	Option C
Sale Price	**8,00,000**	**13,50,000**	**15,10,000**
Less: Balance	(13,00,000)	(13,00,000)	(13,00,000)
Surplus/(Deficit)	(5,00,000)	50,000	2,10,000
• Deficit if any shall be allowed as deduction in the year in which licence is transferred	5,00,000	NA	NA
• Surplus if any shall be taxed U/S. 35ABB which shall be lowest of following :		**50,000**	**2,00,000**
(a) Surplus	NA	50,000	2,10,000
(b) Deduction claimed till date	NA	2,00,000	2,00,000

Computation of Capital Gain

Period of holding:

- ✓ Period of holding is from **05.04.2017 to 20.12.2019** (i.e., not exceeding 36 months)
- ✓ So the gain would be considered as short term capital gain.

Particulars	Option A	Option B	Option C
Full value of consideration	8,00,000	13,50,000	15,10,000
Less: Cost of Acquisition	(15,00,000)	(15,00,000)	(15,00,000)
Short Term Capital Gain/(Loss)	(7,00,000)	(1,50,000)	10,000

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Reader's Note:

Practical 12

Suppose in above problem, Y Ltd. transfers a part (60 per cent) of telecom licence for (a) Rs.7,80,000 or (b) Rs. 16,90,000 on **December 20, 2019**. Compute the amount chargeable to tax.

Solution

Computation of Deduction under section 35ABB & Taxable Income under the head 'PGBP'

Option A

Particulars	Rs.
Balance as on date of sale	13,00,000
Less: Sale Proceeds on transfer of 60% of telecom license	(7,80,000)
Balance	5,20,000
Deduction under Section 35ABB for remaining 13 years [i.e., 5,20,000 ÷ 13]	40,000

Option B

Particulars	Rs.
Balance as on date of sale	13,00,000
Less: Sale Proceeds on transfer of 60% of telecom license	(16,90,000)
Surplus	3,90,000

Since there is a surplus, no deduction is allowed under section 35ABB in the year of sale.

However, Surplus if any shall be taxed U/S. 35ABB which shall be lowest of following:

(a) Surplus	3,90,000
(b) Deduction claimed till date	2,00,000
Taxable Business Income for P.Y. 2019-20	**2,00,000**

Computation of Capital Gain

Period of holding:

- ✓ Period of holding is from **05.04.2017** to **20.12.2019** (i.e., not exceeding 36 months)
- ✓ So the gain would be considered as short term capital gain.

Particulars	Option A	Option B
Full value of consideration	7,80,000	16,90,000
Less: Cost of Acquisition (60% of 15,00,000)	(9,00,000)	(9,00,000)
Short Term Capital Gain/(Loss)	**(1,20,000)**	**7,90,000**

Reader's Note:

5.11 EXPENDITURE FOR OBTAINING RIGHT TO USE SPECTRUM FOR TELECOMMUNICATION SERVICES

Section:- 35ABA [Inserted by Finance Act, 2016 effective from A.Y. 2017-18]

- The provisions of section 35ABB shall apply as if for the word "licence", the word "spectrum" had been substituted.
- Further, any deduction has been claimed and granted to the assessee under this section, and subsequently, there is failure to comply with any of the provisions of this section, then-
  (a) The deduction shall be deemed to have been wrongly allowed
  (b) The assessing officer may, re-compute total income of the assessee for the said previous year and make necessary rectification invoking section 154 of the Act.

5.12 EXPENDITURE ON ELIGIBLE PROJECT OR SCHEMES

Section:- 35AC

Note: No deduction shall be allowed under this section with effect from A.Y. 2018-19. [Amendment by Finance Act, 2016]

5.13 EXPENDITURE BY WAY OF PAYMENT TO ASSOCIATIONS AND INSTITUTIONS FOR CARRYING OUT RURAL DEVELOPMENT PROGRAMMES

Section:- 35CCA

Applicability	Nature of expenditure
All Assessee	Contribution made to: (i) approved association institutions for implementation of rural development programme (ii) training of Employees of above institutions (iii) National Fund for Rural Development (iv) National Urban Poverty Eradication Fund

Withdrawal of approval granted to the association, college or other institution referred to in section 35(2AA), 35AC and 35CCA, the deduction available to the assessee in respect of any sum paid to such a scientific research association, college or other institution shall not be denied merely on this ground.

However, for the purpose of section 35 AC, where the approval granted to an institute is withdrawn, the entire amount of contribution or donation received by such entity shall be deemed to be the income of the previous year in which approval is withdrawn. It is taxable at maximum marginal rate without any exemption available under any provisions of Act.

5.14 EXPENDITURE ON AGRICULTURAL EXTENSION PROJECT

Section:- 35CCC

Where an assessee incurs any expenditure on agricultural extension project notified by the Board in this behalf in accordance with the guidelines as may be prescribed, then, there shall be allowed a deduction of a sum equal to one and one-half times of such expenditure.

However, weighted deduction will not be available from the assessment year 2021-22 onwards.

5.15 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 in this behalf in accordance with the guidelines as may be prescribed, then, there shall be allowed a deduction of a sum equal to one and one-half times of such expenditure.

However, weighted deduction will not be available from the assessment year 2021-22 onwards.

5.16 DEDUCTION IN RESPECT OF EXPENDITURE ON SPECIFIED BUSINESS

Section:- 35AD

(1) Conditions

(a) Assessee must be carrying on "specified business".

(b) The specified business should not be set up by splitting up, or the reconstruction, of a business already in existence.

Not only that, it should not be set up by the transfer of old plant and machinery. However, in following two cases old machinery is permitted:

Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

Case 2:- Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.

(c) Books of account of the assessee must be audited.

(2) Quantum of Deduction

Sr. No.	Specified business	Quantum of deduction (Percentage of capital Expenditure)
1.	Setting up and operating a cold chain facility **(Refer Note 1)**	100%
2.	Setting up and operating a warehousing facility for Storage of agricultural produce	100%
3. *	Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network. **(Refer Note 2)**	100%
4.	Building and operating anywhere in India a new hotel of 2 star or above category **(Refer Note 3)**	100%
5.	Building and operating anywhere in India, new hospital with at least 100 beds for patients	100%
6.	Developing and building a housing project under a scheme for slum redevelopment or rehabilitation	100%
7.	Developing and building a housing project under a scheme for affordable housing	100%
8.	Production of fertilizer in India	100%
9.	setting up and operating an inland container depot or a container freight station	100%
10.	Bee-keeping and production of honey and beeswax	100%
11.	setting up and operating a warehousing facility for storage of sugar	100%
12.	Laying and operating a slurry pipeline for the transportation of iron ore	100%
13.	Setting up and operating a semiconductor wafer fabrication manufacturing unit.	100%
14. *	Developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility (Amendment by Finance Act, 2016 but effective from A.Y. 2018-19) **(Refer Note 4)**	100%

* The benefit of deduction under this section is available to a company formed under Companies Act, 1956 or a consortium of such companies or an authority or a board or a corporation established under Central or State Act.

Notes

1. "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.
2. This business shall make not less than one-third (for a natural gas pipeline network) or one-fourth (for petroleum product pipeline network) of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person. Associated person is a person who participates in the management of the assessee; holds at least 26 per cent voting power in the assessee; appoints more than half of the board of directors or who guarantees not less than 10 per cent of the total borrowing of the assessee.
3. 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.
4. infrastructure facility" means—
   - **(i)** a road including toll road, a bridge or a rail system;
   - **(ii)** a highway project including housing or other activities being an integral part of the highway project;
   - **(iii)** a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;
   - **(iv)** a port, airport, inland waterway, inland port or navigational channel in the sea.

(3) Year of Deductibility

Above mentioned deduction under section 35AD in respect of any capital expenditure (whether old or new) shall be allowed in the previous year in which such capital expenditure is incurred.

In case of expenditure incurred prior to the commencement of specified business, the same shall be allowed as deduction during the previous year in which the assessee commences the operation specified business, if the amount is capitalized in the books of account on the date of commencement of specified business.

(4) Restrictions

Capital expenditure incurred on the following shall not be eligible for deduction under section 35AD

(i) land

(ii) goodwill

(iii) financial instrument

(iv) any capital expenditure in respect of which the payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account, exceeds ten thousand rupees. (Inserted by Finance Act, 2017, w.e.f. A.Y. 2018-19)

Practical 13

Priyanka warehouse LLP set up the operation of warehousing facility in Gujarat for storage of agricultural produce. It commenced operation with effect from April 1, 2017.

The following information is available from the records of LLP.

Particulars	Rs.
Expenses incurred prior to April 1, 2017 and capitalized in the books	
Purchase of land for warehouse	80,00,000
Construction cost of warehouse (Material)	12,00,000
Payment to labour contractor for construction of warehouse (single payment made in cash)	7,00,000
Expenses incurred during 2017-18	
Further construction cost of warehouse	50,00,000
Purchase of old plant and machinery (from India)	2,50,000
Purchase of old plant and machinery (from Denmark)	3,50,000
Purchase of new plant and machinery	9,00,000

Compute amount of deduction under section 35AD assuming that the books of accounts of Priyanka warehouse LLP have been audited.

Solution

Statement showing computation of deduction under section 35AD in the hands of Priyanka warehouse LLP:

Particulars	Rs.
Expenses incurred prior to April 1, 2017 and capitalized in the books	
Purchase of land for warehouse	Not Eligible for 35AD benefit
Construction cost of warehouse	12,00,000
Payment to labour contractor for construction of warehouse (Not eligible because single payment is made in cash exceeding Rs.10,000)	Nil
Expenses incurred during 2017-18	
Further construction cost of warehouse	50,00,000
Purchase of old plant and machinery (from India)	2,50,000
Purchase of old plant and machinery (from Denmark)	3,50,000
Purchase of new plant and machinery	9,00,000
Total Deduction under section 35AD	**77,00,000**

Reader's Note:

(5) Consequences Of Claiming Deduction Under Section 35AD

A. Basic Consequences

(i) Once deduction has been claimed in respect of capital expenditure under section 35AD, the same cannot be claimed under any other provisions of the Income-tax Act. (e.g., depreciation under section 32, Investment allowance under section 32 AD cannot be claimed for the same capital expenditure.)

(ii) Once deduction is claimed under this section, the assessee shall not be allowed any deduction in respect of the specified business under section 10AA and sections 80HH to 80RRB for the same or any other assessment year. Readers must note that all other deductions under 80C to 80U can be claimed except deductions starting from Section 80HH to 80RRB. (For example, deduction under 80G, 80GGA, 80GGB etc., can be claimed)

(iii) Further, loss from specified business shall not be set off except against profits and gains of any other specified business. Any unabsorbed loss from specified business shall be carried forward for indefinite period. After carry forward, the same shall be adjusted against profit of specified business only.

(iv) For the purpose of set off of losses only, in respect of the business of hotels and hospitals, the word "new" has been removed from the definition of "specified business".

As a result, any (old) hotel of two star above or any (old) hospital having atleast 100 beds for patients will qualify as specified business for the purpose of set off of losses.

Practical 14

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on **1.4.2017.** The company incurred capital expenditure of Rs. 50 lakh during the period **January, 2017 to March, 2017** exclusively for the above business, and capitalized the same in its books of account as on **1st April, 2017**. Further, during the **P.Y.2017-18**, it incurred capital expenditure of Rs. 2 crore (out of which Rs. 1.50 crore was for acquisition of land) exclusively for the above business.

Compute the income under the head "Profits and gains of business or profession" for the **A.Y.2018-19**, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD. The profits from the business of running this hotel (before claiming deduction under section 35AD) for the **A.Y.2018-19** is Rs. 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations few years back (time when section 35AD was not there in Income Tax Act, 1961), the profits from which are Rs. 120 lakhs for the **A.Y.2018-19**.

Solution

Particulars	Rs. In Lakhs	Rs. In Lakhs
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)		25
Less: **Deduction under section 35AD**		
Capital expenditure incurred during the **P.Y.2017-18** (excluding the Expenditure incurred on acquisition of land)	50	
Capital expenditure incurred prior to **1.4.2017** (i.e., prior to commencement of business) and capitalized in the books of account as on **1.4.2017**	50	
Total deduction under section 35AD for **A.Y.2018-19**		100
Loss from the specified business of new hotel in Madurai		**(75)**
Profit from the existing business of running a hotel in Coimbatore		120
Net profit from business after set-off of loss of specified business		**45**

Note:- In respect of the business of hotels and hospitals, the word "new" has been removed from the definition of "specified business". Therefore, four star hotel at Coimbatore also fall within the definition of "specified business".

Consequently, the loss of hotel at Madurai can be set-off against the profit of another specified business under section 73A.

Reader's Note:

B. Other Consequences of Claiming Deduction under section 35AD

(a) An asset (in respect of which a deduction has been claimed and allowed under section 35AD) shall be used only for the specified business for a period of 8 years beginning with the previous year in which such asset is acquired or constructed.

(b) If such asset is used for any purpose other than the specified business during the abovementioned 8 years, then following shall be deemed to be income of the assesse of the previous year in which the asset is so used. [Section 35AD(7B)]

Particulars	Rs. in lakhs
Total amount of deduction claimed under section 35AD	XXXXX
Less: Amount of depreciation allowable in accordance with the provisions of section 32, as if no deduction had been allowed u/s 35AD	(XXX)
Deemed income under section 35AD (7B)	XXXXX

(c) However, this provision will not apply to a company which has become a sick industrial company, under section 17(1) of the Sick Industrial Companies (Special Provisions) Act within the time period of abovementioned 8 years.

(d) If any sum received or receivable on account of any capital asset, in respect of which deduction has been claimed under section 35AD, being demolished, destroyed, discarded or transferred then same shall be treated as income and chargeable to tax under the head "Profits and gains of business or profession". [Section 28(vii)]

Practical 15

ABC Ltd. set up warehousing unit for storage of agricultural produce on **10.06.2015.** The construction cost of warehouse was Rs. 75 lacs on which weighted deduction (150%) was claimed under section 35AD. However, it started using this warehouse for storage of edible oils with effect from **01.04.2017.** Discuss tax consequences for the assessment year **2018-19** in the hands of ABC Ltd.

Solution

Since the warehouse of specified business has been used for non-specified business (for storage of edible oils) in the **P.Y.2017-18**, the deeming provision under section 35AD(7B) shall be applicable.

Particulars	Rs.
Total amount of deduction claimed under section 35AD [150% of Rs. 75 Lacs)	1,12,50,000
Less: Depreciation allowable u/s 32 (Refer working note)	14,25,000
Deemed income under section 35AD(7B)	**98,25,000**

Working Note: Computation of depreciation allowable under section 32 for earlier years had deduction under 35AD not claimed.

	Particulars	Rs.
	Cost of Building	75,00,000
Less:	Depreciation for the previous year **2015-16** [10%]	7,50,000
		67,50,000
Less:	Depreciation for the previous year **2016-17** [10%]	6,75,000
		60,75,000
	Total Depreciation [Rs.7,50,000 + Rs.6,75,000]	**14,25,000**

Reader's Note:

Practical 16

What would have been your answer in the above practical if ABC Ltd had sold out this warehouse building for Rs. 82 lacs on **01.04.2017**?

Solution

As per section 28(vii), entire amount received Rs. 82 lac on sale of building is deemed to be the business income for the **A.Y.2018-19.**

Reader's Note:

5.17 AMORTISATION OF PRELIMINARY EXPENSES

Section:- 35D

(1) Eligible Assessee

Indian company or a non-corporate resident assesse

(2) Time and purpose of incurring preliminary expenses:

Time of Incurring expenses	Purpose of expenses
Before commencement of business	For setting up of any undertaking or business
After commencement of business	Extension of the undertaking or setting up new unit

(3) List of specified expenditure

The work shall be carried on by the assessee **itself** or by a **concern** approved **by the Board**	The work can be carried on by the assessee **itself** or by **any concern** (approved or not approved)
Expenditure in connection with :- • preparation of feasibility report, • preparation of project report, • conducting a market survey or • engineering services relating to the business of the assessee.	• Legal charges for drafting any agreement between the assessee and any other person relating to the setting up of the business of the assessee. • Legal charges for drafting the memorandum and articles of association if the taxpayer is a company.

	• Printing expenses of the memorandum and articles of association if the taxpayer is a company. • Registration fee of a company under the provisions of the Companies Act. • Expenses in connection with the public issue of shares or debentures of a company, underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus. • Any other expenditure which may be prescribed.

(4) Maximum qualifying expenditure:

In the case of a corporate assessee	**In the case of a non-corporate assessee**
a. 5 per cent of cost of project; or b. 5 per cent of capital employed, whichever is more	5 per cent of cost of project

(5) Quantum of Deduction

The maximum qualifying expenditure as computed above will be allowed as a deduction in 5 equal installments starting from the previous year in which the business commences.

(6) Meaning of certain terms

(a) Capital employed

- It is the aggregate of the issued share capital, debentures and long-term borrowings, as on the last day of the previous year in which the business of the company commences.
- Long-term borrowings - The term "long-term borrowing" in the above context, includes following—

From whom borrowed?	***Time period in which the loan is repayable***
Any money borrowed by the company from the **(a)** Government or **(b)** the Industrial Finance Corporation or India or **(c)** the Industrial Credit and Investment Corporation of India or **(d)** any other financial institution which is eligible for deduction under section 36(1)(viii) or **(e)** any banking institution	No time period prescribed.
Any money borrowed or debt incurred by the company in foreign country in respect of purchases outside India of capital plant and machinery	Repayable for a period of not less than 7 years

(b) Cost of the project

It means the actual cost of fixed assets namely, land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences.

(7) Audit Report

In case of non-corporate assesses, the assessee is required to furnish the audit report in Form 3B along with the return of income for the first year.

Practical 17

Vita biscuit Limited (VBL) was incorporated on **1st November, 2016**. However, it started commercial production on **14th February, 2018**. VBL incurred following preliminary expenses before commencement:

(a) registration fees for incorporation : Rs. 20,000 ;

(b) legal charges for drafting the memorandum, articles and prospectus etc. : Rs. 50,000 ;

(c) printing expenses of memorandum, articles, prospectus, etc. : Rs. 30,000 ;

(d) Advertisements expenses for issue of shares : Rs. 1,00,000;

(e) Underwriting commission for issue of shares : Rs. 3,75,000 ;

(f) Expenditure on preparation of feasibility report (the work is undertaken by the VBL) : Rs. 75,000 ;

(g) Expenditure on preparation of the project report (the work is undertaken by an approved concern) : Rs. 50,000;

(h) Expenditure on conducting market survey necessary (the work is undertaken by a concern which is not approved for this purpose) :Rs. 85,000;

(i) Legal charges for foreign collaboration agreement : Rs. 2,00,000 ;

(j) Expenditure on engineering services in connection with the erection of plant and machinery : Rs. 3,50,000.

Following is the extract of balance sheet of VBL

	On **March 31, 2017** Rs.	On **March 31, 2018** Rs.
Cost of fixed assets (excluding engineering services)	17,00,000	1,32,50,000
Issued share capital	1,00,000	1,50,00,000
Paid up share capital	1,00,000	1,30,00,000
Debentures	10,00,000	10,00,000
Long-term borrowing in foreign country	9,00,000	15,00,000

Determine the amount deduction under section 35D.

Solution

Step 1: Total Qualifying Amount

Particulars	Rs.
Registration fees	20,000
Legal charges for darting	50,000
Printing expenses	30,000
Advertisement expenses	1,00,000
Underwriting Commission	3,75,000
Expenditure on preparation of feasibility report	75,000
Expenditure on preparation of project report	50,000
Expenditure on conducting market survey (not eligible as the work is undertaken by an unapproved concern)	Nil
Legal Charges for foreign collaboration agreement	2,00,000
Expenditure on engineering services (it is beneficial to capitalize)	Nil
Total Qualifying Amount	**9,00,000**

Step 2: Limit on Total Qualifying Amount is higher of the following

(1) 5% of Cost of the project on **March 31, 2018**

5% (Rs.1,32,50,000 + Rs.3,50,000=Rs.1,36,00,000 x 5%)

Rs. 6,80,000

(2) 5% of Capital Employed on **March 31, 2018**

5% of (i.e., Rs.1,50,00,000 + Rs.10,00,000 + Rs.15,00,00=Rs.1,75,00,000)

Rs.8,75,000

Step 3: Maximum Qualifying Amount is lower of

Step 1: Rs. 9,00,000

Step 2: **Rs. 8,75,000**

Step4: Amount of deduction under section 35D = step 3 /5 years

= Rs.8,75,000 / 5 years

= Rs.1,75,000

Above amount is to be allowed as deduction u/s. 35D beginning with the previous year in which assessee commences business i.e. **previous year 2017-18**.

Reader's Note:

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(8) How to compute deduction under section 35D in case of extension of undertaking

(a) Meaning of capital employed:

It is the aggregate of issued share capitals debentures and long-term borrowing as on the last day of the previous year in which the extension of undertaking is completed or, as the case may be, the new industrial unit commences production or operation, insofar as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new industrial unit of the company.

(b) Meaning of Cost of project

The cost of project is defined to mean the actual cost of fixed assets, as stated above, which are shown in the books of the assessee as on the last day of the previous year in which the extension of undertaking is completed, or, as the case may be, the new unit commences production or operation in so far as such fixed assets have been acquired or developed in connection with the extension of the undertaking or selling up of the new unit of the assessee.

In case of extension of undertaking, deduction shall be allowed in 5 equal installments starting from the previous year in which extension of undertaking is completed.

5.18 AMORTISATION OF EXPENDITURE IN CASE OF AMALGAMATION / DEMERGER

Section:- 35DD

(1) Eligible Assessee

Indian company

(2) Quantum of Deduction

The expenditure incurred wholly and exclusively for the purpose of amalgamation or demerger shall be allowed as a deduction in 5 equal instalments beginning with the previous year in which the amalgamation or demerger took place

5.19 EXPENDITURE ON PROSPECTING FOR CERTAIN MINERALS

Section:- 35E

(1) Eligible Assessee

Indian company or non-corporate resident assesse

(2) List of Expenditure

Eligible expenditure	Ineligible expenditure
Expenditure incurred wholly for operation relating to prospecting of such mineral or group of minerals specified in VII Schedule or on the development of mine or other natural deposits of such mineral or group of minerals	**(a)** Expenditure which is met directly or indirectly by any person or authority **(b)** Expenditure on acquisition of site of the source of any mineral **(c)** Expenditure on acquisition of deposits of such minerals or any rights in or over such deposits **(d)** Capital expenditure on any building, plant and machinery or furniture for which depreciation is admissible u/s. 32

(3) Time frame of incurring eligible expenditure

The expenditure shall be incurred at any time during the year of commercial production **and** 4 years immediately preceeding the year of commercial production.

(4) Quantum of Deduction

Deduction is available in 10 equal installments against income from mining (whether new mine or old mine) commencing with the previous year of commercial production.

(5) Adjustment of unabsorbed deduction

If income from mining is not sufficient to absorb 1/10th deduction, then such unabsorbed deduction shall be carried forward to be adjusted against future mining income. **But such unabsorbed deduction will lapse on** the expiry 10 years from the commencement of production.

Practical 18

Amrapali Kutch Clay Co. (AKCC), a partnership firm, is engaged in business of production of minerals since 30 years. It developed new mine at Kutch and started commercial production with effect from **1st December, 2017**. AKCC incurred following expenditure in connection with new mine at Kutch:

Particulars	Rs.
Expenses for prospecting mineral upto **31.03.2013**	2,00,000
Expenses for prospecting mineral from **01.04.2013 to 01.12.2017**	15,50,000
Out of Rs. 15,50,000, amount met by Gujarat Government	50,000
Payment made to farmer on **10.08.2016** for acquisition of rights over deposit	18,00,000
Purchase of few plant and machinery on **10.09.2016**	11,00,000

Compute the income of AKCC under the head "PGBP" for the previous year **2017-18** and **2018-19** from the following information:

Particulars	Previous year 2017-18 (Rs.)	Previous year 2018-19 (Rs.)
Income from mining division (before claiming deduction u/s 35E)		
- from old mines	1,26,000	2,50,000
- from new mine at Kutch	4,000	90,000
Other business income	3,00,000	3,50,000

Solution

Step 1: Qualifying Expenditure

Particulars	Rs.
Expenditure incurred upto **31.03.2013** [Beyond 4 years hence not eligible]	Nil
Expenditure during **01.04.2013 to 31.03.2017** (Rs. 15,50,000 - Rs.50,000)	15,00,000
Payment made to farmer for acquisition of rights over deposit (Ineligible)	Nil
Purchase of few plant and machinery (Ineligible)	Nil
Total Qualifying Expenditure	**15,00,000**

Step 2: Deduction under section 35E

Deduction starting from P.Y 2016-17 = $\frac{Step\ 1}{10\ years}$

= $\frac{Rs.15,00,000}{10}$ = Rs.1,50,000

Computation of Business Income for the P.Y. 2017-18

Particulars	Rs.
Mining Income (Old + New)	1,30,000
Less: Deduction under section 35E (to the extent absorbed)	(1,30,000)
Income from mining business **(A)**	Nil
Add: Other Business Income **(B)**	3,00,000
Taxable Income under the head "PGBP" (A + B)	**3,00,000**

NOTE:

Unabsorbed deduction under section 35E which can be adjusted in subsequent years: 1,50,000 – 1,30,000= Rs.20,000.

Computation of Business Income for the P.Y. 18-19

Particulars	Rs.
Mining Income (Old + New)	3,40,000
Less: Deduction under section 35E (Rs.1,50,000 + Rs.20,000 unabsorbed)	(1,70,000)
Income from mining business **(A)**	1,70,000
Add: Other Business Income **(B)**	3,50,000
Taxable Income under the head "PGBP"(A + B)	5,20,000

Reader's Note:

5.20 EXPENDITURE ALLOWABLE

Section:- 36

The following deduction shall be allowed while computing income under the head PGBP under section 36 of the Act

5.20A INSURANCE PREMIUM FOR STOCKS OR STORES

Section:- 36(1)(i)

Premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purpose of business or profession.

5.20B INSURANCE PREMIUM ON THE LIFE OF CATTLE

Section:- 36(1)(ia)

Premium paid by a federal milk co-operative society for an insurance on the life of cattle owned by a member of a primary co-operative society.

5.20C INSURANCE PREMIUM ON THE HEALTH OF EMPLOYEES

Section:- 36(1)(ib)

Premium paid by any mode of payment other than cash 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 by GIC or any other insurer approved by IRDA.

5.20D BONUS OR COMMISSION TO EMPLOYEES

Section:- 36(1)(ii)

Sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend.

5.20E INTEREST ON BORROWED CAPITAL

Section:- 36(1)(iii)

Interest paid in respect of capital borrowed for the purposes of the business or profession.

However any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

Practical 19

MATA Motors Limited purchased new machine for Rs. 14,80,000 on **01.05.2017** under an extension of its existing manufacturing unit at Sanand. This machine was partly financed by State Bank of India amounting to Rs. 10,00,000 carrying 12 % p.a. simple interest. The said machine was put to use on **01.07.2017**. Find out the amount of depreciation and additional depreciation in the hands of MATA Motors Limited.

Solution

Before we refer solution, consider the requirements of ICDS IX and the provisions of explanation 8 to section 43(1) first.

ICDS IX

ICDS IX on borrowing costs requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset.

Explanation 8 to Section 43(1)

Situation	Notional cost under-section 43(1)
Asset is purchased with the help of borrowed fund.	Then, any amount paid or payable as interest in connection with the acquisition of an asset and relatable to a period after the asset is first put to use will not form part of actual cost.

Considering the provisions of section 36(1)(iii), explanation 8 to section 43(1) and the requirements of ICDS IX, any interest paid during the period beginning from the date of borrowing till the date on which asset was put to use, shall not be allowed as deduction but the same shall be capitalized.

Computation of Actual Cost of Asset

Particulars	Rs.
Original Cost	14,80,000
Interest capitalization for a period of two months $\left(10{,}00{,}000 \times \frac{12}{100} \times \frac{2}{12}\right)$	20,000
Actual Cost for the purpose of Depreciation	15,00,000
Depreciation at the rate of 15%	2,25,000
Additional depreciation at the rate of 20%	3,00,000

Reader's Note:

5.20F | DISCOUNT ON ZERO COUPON BONDS

Section:- 36(1)(iiia)

The pro rata amount of discount on a zero coupon bond issued by the Infrastructure Capital Company or Infrastructure Capital Fund or Public Sector Company or Scheduled Bank having regard to the period of life of such bond calculated in the manner as may be prescribed (Rule 8C)

Meaning of certain terms

Discount means the difference between amount received and the amount payable on redemption or maturity of zero coupon bonds by the issuing entity.

The period of life of bond means the period commencing from the date of issue of the bond and ending on the date of maturity or redemption of such bond.

Rule 8C

The pro rata amount of discount on a zero coupon bond shall be computed in the following manner:-

(a) the period of life of the bond shall be converted into number of calendar months and, for this purpose, where the calendar month in which the bond is issued or the bond matures or is redeemed contains a part of a calendar month then, if such part is fifteen days or more than fifteen days, it shall be increased to one calendar month and if such part is less than fifteen days it shall be ignored;

(b) the amount of discount shall be divided by the number of calendar months determined in accordance with clause (a);

(c) where one or more than one calendar month out of calendar months determined in accordance with clause (a) is or are included in a previous year, the amount determined in accordance with clause (b) shall be multiplied by the number of calendar months so included and the amount so arrived at shall be taken to be the pro rata amount of discount for that previous year.

Practical 20

Infrastructure Development Finance Company Limited issued Zero coupon bonds (notified by the Central Government), details of which are as under:

(a) Date of issue of bond:- **October 14, 2017**

(b) Issue Price of each bond: Rs. 60

(c) Face Value of each bond (i.e. amount payable at the time of redemption) : Rs.100

(d) Redemption date: **July 15, 2027**

(e) Number of bonds subscribed by public: 10,00,000.

Find out deduction under section 36(1)(iiia) for the previous year **2017-18**.

Solution

(a) Life of Bond [**From 01.10.2017 to 31.07.2027**]	118 Months
(b) Discount Per Bond [Face Value -Issue Price]	Rs.40
(c) Total Discount [10,00,000 bonds x Rs.40]	Rs.4,00,00,000
(d) Deduction per month for discount [4,00,00,000 ÷ 118 months]	3,38,983
(e) Deduction for the previous year **2017-18** [Rs.3,38,983 x 6 months]	Rs.20,33,898

Reader's Note:

5.20G EMPLOYER'S CONTRIBUTION TOWARDS PROVIDENT FUND

Section:- 36(1)(iv)

Sum paid by the assessee as an employer by way of contribution towards a recognised provident fund or an approved superannuation fund subject to limits as may be prescribed and further subject to conditions as Board may specify.

5.20H EMPLOYER'S CONTRIBUTION TOWARDS PENSION SCHEME REFERRED TO IN SECTION 80CCD

Section:- 36(1)(iva)

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.

However, such deduction shall not exceed ten per cent of the salary of the employee in the previous year.

Meaning of Salary

"Salary" includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

5.20I EMPLOYER'S CONTRIBUTION TOWARDS AN APPROVED GRATUITY FUND

Section:- 36(1)(v)

Sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust.

5.20J EMPLOYEE'S CONTRIBUTION TOWARDS PROVIDENT FUND/ESI/WELFARE FUND

Section:- 36(1)(va)

As per section 2(24)(x), any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948, or any other fund for the welfare of such employees is first treated as income.

Thereafter, deduction shall be allowed under section 36(1)(va), 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 under the relevant Act for the relevant Fund.

5.20K ALLOWANCE IN RESPECT OF DEAD OR PERMANENTLY USELESS ANIMALS

Section:- 36(1)(vi)

Allowance in respect of dead or permanently useless animals which were used for the purpose of business or profession.

Amount of allowance under this section = Actual cost of animals Less Amount realised on sale of the animal or their carcasses.

However, such allowance shall not be available for the animals which are held as stock-in-trade.

5.20L BAD DEBT

Section:- 36(1)(vii) and 36(2)

(1) Deduction in respect of bad debt subject to following conditions:-

- The debt must be incidental to the business.
- It must have been taken into account in computing the income of the assessee.
- The debt may be money lent in the ordinary course of banking or money lending business.
- The business in which such debt is incurred should be continued during the previous year.
- Bad debt must have been written off in the books of the assessee.
- Further, if a debt, which has not been recognized in the books of account as per the requirement of the accounting standards but has been taken into account in the computation of income as per the notified ICDS, has become irrecoverable, it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts.

(2) Additional points

- Provision for bad and doubtful debts shall not be allowed as deduction.
- As per section 41(4), bad debts earlier allowed which has been subsequently recovered shall be taxed under this head in the year in which it has been recovered.

Practical 21

Mr. Joy, a trader, generally sells goods on credit to RUNWAY & Co. He provides following information for the previous year **2017-18**.

(a) Amount recoverable from RUNWAY & C. as on **1st April, 2017** : Rs. 10,000

(b) Credit Sales made during the previous year **2017-18**: Rs. 1,90,000

(c) Amount recovered during the previous year **2017-18** in cash: Rs. 50,000

(d) Amount written off as bad debt for the previous year **2017-18**: Rs. 30,000

Discuss tax consequences in the hands of Mr. Joy, if he recovers from RUNWAY & Co. following amount as full and final payment on **10th October, 2018**.

Alternative (a) : Rs. 1,00,000

Alternative (b): Rs. 1,35,000

Solution

In the books of Mr. Joy

RUNAWAY & Co.

From 01.04.2017 to 31.03.2018

Particulars (Dr.)	Rs.	Particulars (Cr.)	Rs.
To Opening Balance	10,000	By Cash	50,000
To Sales	1,90,000	By Bad Debt	30,000
		By Closing Balance	1,20,000
	2,00,000		**2,00,000**

Alternative	Amount of Debt as on 01.04.2018 (Rs.)	Amount recovered as full and final payment (Rs.)	Deficit /surplus (Rs.)	Tax Treatment for the previous year 2018-19
(a)	1,20,000	1,00,000	(20,000)	Allowed as deduction under section 36(1) (vii)
(b)	1,20,000	1,35,000	15,000	Taxable under section 41(4)

Reader's Note:

Practical 22

Mohak Finance Ltd., Non-banking finance company, lent Rs. 5,00,000 to Mr. Raghav on **01.04.2017** @ 18 % p.a. Under the agreed terms, Mr. Raghav is supposed to serve interest quarterly. However, Mr. Raghav failed to pay interest for the fourth quarter. Not only that, Mr. Raghav was declared insolvent in the month of **March, 2018**. Mohak Finance Ltd., therefore, sold the gold pledged by Mr. Raghav and realized Rs. 4,42,000. However, Mohak Finance Ltd. recorded Rs. 67,500 interest income for the first, second and third quarter in the books of accounts.

From the above information, you are required to:

(a) Compute the interest income to be offered by Mohak Finance Ltd. for the financial year **2017-18** in view of ICDS IV.

(b) Further, compute the amount of bad debt which can be claimed by Mohak Finance Ltd. in the financial year **2017-18** under section 36(1)(vii).

Solution

(a) In view of requirements of ICDS IV, Mohak Finance Ltd. is required to offer interest income of Rs. 90,000 for the previous year **2017-18**, even though he has not realized Rs. 22,500 pertaining to the fourth quarter.

(b) Considering the provisions of section 36(1)(vii), Mohak Finance Ltd. can claim deduction of bad debt of Rs. 58,000 pertaining to principal amount in the financial year **2017-18**, provided he writes off the same in the books of accounts.

(c) Further, in view of the second proviso to section 36(1)(vii), Mohak Finance Ltd. can claim deduction of unrealized interest (Rs. 22,500) which has been recognized as income in view of ICDS IV without writing off the same in the books of accounts.

Reader's Note:

5.20M DEDUCTION FOR PROVISION FOR BAD AND DOUBTFUL DEBTS IN CASE OF CERTAIN ASSESSEE

Section:- 36(1)(viia)

Assessee	Amount of Deduction	Additional Deduction in case of Rural Branches	Additional Optional deduction
Any Scheduled, Non-Scheduled or co-operative bank but other than a primary agriculture credit society or a primary co-operative agricultural and rural development bank (Except Foreign Bank)	Not exceeding 7.5% **(8.5% w.e.f. A.Y. 2018-19)** of its total income*	10% of aggregate average advances made by rural branches of Bank.	Further deduction of an amount not exceeding the income derived from redemption of securities in accordance with scheme framed by Government. However, this additional deduction can be claimed only if income from such securities has been offered for taxation under the head "Profits and Gains of Business or Profession".
Any Foreign Bank	5% of its total income*	Not available	Not available
Public Financial Institution or State Financial Corporation or State Industrial Investment Corporation or NBFC			

*Total Income means total income before claiming deduction under this clause and Chapter VIA

Notes:

In the case of an assessee to which section 36(1)(viia) applies, the amount of the deduction relating to any bad debt or part thereof under section 36(1)(vii) shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1) (viia) ***without making any distinction between rural advances and other advances.*** That means, there should be only ***one account in respect of provision for bad and doubtful debts*** without making any distinction between rural advances and other advances.

Practical 23

The following are the particulars in respect of Indian Bank

Sr. No.	Particulars	Rs. in lakhs
(i)	Provision for bad and doubtful debts u/s 36(1)(viia) as on **1st April 2017**	200
(ii)	Gross Total Income of **A.Y.2018-19** [before deduction u/s 36(1)(viia)]	1000
(iii)	Aggregate average advances made by rural branches of the bank (assume that bank opened first time rural branches in previous year **2017-18**).	400
(iv)	Bad debts written off (for the first time) in the books of account (in respect of urban advances only) during the previous year **2017-18**	350

Compute deduction:

(a) in respect of provision for bad and doubtful debt under section 36(1) (viia)

(b) in respect of bad debts under section 36(1)(vii)

Solution

(a) Deduction in respect of provision for bad and doubtful debt under section 36(1) (viia) = Rs. 85 lacs + Rs. 40 Lacs = Rs. 125 Lacs

(b) Deduction in respect of bad debts under section 36(1) (vii) = Rs. 25 Lacs

Working Note:

Provision for Bad-Doubtful Debts A/c

[ONE/SINGLE ACCOUNT]

Dr. **Cr.**

Particulars	Rs. in lakhs	Particulars	Rs. in lakhs
		By Balance b/f	200
		By Profit & Loss A/c [1000 x 8.5%]	85
To Debtors A/c	325	By Profit & Loss A/c [400 x 10%]	40
	325		**325**

Bad-Debts A/c

Dr. **Cr.**

Particulars	Rs. in lakhs	Particulars	Rs. in lakhs
To Debtors A/c [350-325]	25	By Profit & Loss A/c	25
	25		**25**

Reader's Note:

5.20N DEDUCTION IN RESPECT OF TRANSFER TO SPECIAL RESERVE FOR CERTAIN ASSESSEE:

Section:- 36(1)(viii)

Specified entities (mentioned in table given below) shall be entitled to claim additional deduction under this section in respect of an amount transferred to special reserve account out of the profits of eligible business.

Specified Entities	Eligible business
1. Financial Corporation specified under section 4A of the Companies Act, 1956. 2. a financial corporation which is a public sector company 3. Banking Company 4. Co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank)	The business of providing long-term finance in India for (a) industrial or (b) agricultural development or (c) development of infrastructure facility or (d) development of housing in India.
A housing finance company (i.e. a public company formed in India with the main object of carrying on the business of providing long-term finance for purchase or construction of residential house in India)	The business of providing long-term finance for construction or purchase of residential houses in India.
Any other financial corporation including the public company	The business of providing long-term finance for development of infrastructure facility.

Quantum of Deduction

Amount of deduction shall be least of the following:

(i) Amount transferred to special reserve

(ii) 20% of profit of eligible business

(iii) 200% (paid up capital plus general reserve on the last day of previous year) less balance of Special Reserve account on the 1st day of P.Y.

Practical 24

Bandhan Finance Ltd. is a specified entity for the purpose of section 36(1)(viii). For the previous year **2017-18**, you are required to compute deduction under section 36(1)(viii) from the following information.

1. Business profit from eligible business for the previous year **2017-18** (before claiming deduction under this section):Rs. 500 Lakhs
2. Paid-up capital and general reserve as on **31st March, 2018:** Rs. 600 lakh
3. Balance of special reserve account as on **1st April 1, 2017:** Rs. 1,110 lakh (out of which Rs. 910 lakh was allowed as deduction in the earlier years).
4. Amount transferred to special reserve account during **2017-18** is Rs. 120 lakh.

Solution

Deduction u/s 36 (1) (viii) is lowest of following:

Particulars	Rs. In Lakhs	Rs. In Lakhs
(1) Amount transferred to Special reserve		120
(2) 20% of profit of eligible business (20% of Rs.500 lakhs)		100
(3) 200% of (Paid up Capital + Reserves) as on **31.03.2018** (200% of Rs.600 lakhs)	1200	
Less : Opening balance of special reserve as on **01.04.2017**	(1110)	90

Therefore deduction to be claimed by Bandhan Finance Limited under section 36 (1) (viii) is Rs.90 lakh

Reader's Note:

Practical 25

In continuation of above problem, Bandhan Finance Limited has withdrawn Rs. 250 Lakhs on **10th June, 2018**. Discuss tax consequences of such withdrawal.

Solution

Before we refer solution, let's consider provisions of section 41(4A).

As per provisions of section 41(4A), any amount withdrawn from special reserve (for which deduction has been claimed in past under section 36(1)(viii)) shall be taxed in the year in which it has been withdrawn.

Following amount shall be taxed in the hands of Bandhan Finance Ltd. for the previous year **2018-19.**

Particulars	Rs. In lakhs
Amount withdrawn from special reserve	250
Less: Amount that can't be taxed because no deduction had been claimed in past **[W.N.]**	(230)
Amount taxable in **P.Y. 2018-19**	20

Working Note: Amount that can't be taxed because no deduction had been claimed in past

Particulars	Rs. In lakhs
Opening balance of special reserves	1110
Add: Created during previous year **2017-18**	120
	1230
Less: Deduction claimed in past	
(1) Rs.910 lakhs	
(2) Rs. 90 lakhs	(1000)
Balance amount on which no deduction had been claimed in past	**230**

Reader's Note:

5.20O DEDUCTION IN RESPECT OF EXPENDITURE INCURRED BY CERTAIN CORPORATION OR BODY CORPORATE

Section:- 36(1)(xii)

Expenditure incurred by a corporation or a body corporate, by whatever name called, if,—

(a) it is constituted or established by a Central, State or Provincial Act;

(b) such corporation or body corporate, having regard to the objects and purposes of the Act referred to in sub-clause (a), is notified by the Central Government in the Official Gazette for the purposes of this clause; and

(c) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted or established;

However, capital expenditure shall not be allowed as deduction.

5.20P DEDUCTION IN RESPECT OF BANKING CASH TRANSACTION TAX

Section:- 36(1)(xiii)

Any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him.

5.20Q DEDUCTION IN RESPECT OF CONTRIBUTION TO CREDIT GUARANTEE FUND TRUST

Section:- 36(1)(xiv)

Any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries as the Central Government may, by notification in the Official Gazette, specify in this behalf.

5.20R DEDUCTION IN RESPECT OF SECURITIES TRANSACTION TAX

Section:- 36(1)(xv)

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".

5.20S DEDUCTION IN RESPECT OF COMMODITIES TRANSACTION TAX

Section:- 36(1)(xvi)

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".

5.20T DEDUCTION IN RESPECT OF PURCHASE OF SUGAR-CANE

Section:- 36(1)(xvi)

The amount of expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price which is equal to or less than the price fixed or approved by the Government.

Practical 26

Assessee co-operative society engaged in the business of manufacture of Sugar has purchased the sugarcane in different lots at following prices:

Lot No.	Price Paid by the Assessee	Price Fixed by the Government
1.	25,52,000	24,48,000
2.	31,32,000	31,35,000
3.	12,43,400	12,43,400
4.	16,18,350	16,18,200

Find out the deduction that co-operative society can claim towards purchase of sugarcane.

Solution

Considering the above, the deduction that co-operative society can claim towards purchase of sugarcane is as under:

Lot No.	Price Paid by the Assessee	Price Fixed by the Government	Deduction u/s 36(1)(xvii)
1.	25,52,000	24,48,000	24,48,000
2.	31,32,000	31,35,000	31,32,000
3.	12,43,400	12,43,400	12,43,400
4.	16,18,350	16,18,200	16,18,200
Total			84,41,600

Reader's Note:

5.21 GENERAL DEDUCTION

Section:- 37(1)

Conditions for allowability of expenditure:

(1) The expenditure should not be in the nature as prescribed u/s. 30 to 36.
(2) It should be incurred in connection with business or profession carried on by the assessee.
(3) It should have been expended wholly and exclusively for the purpose of such business or profession.
(4) The expenditure should not be in the nature of capital expenditure
(5) It should not be of personal expenditure
(6) It should be incurred during the previous year.

Explanation 1:- No deduction shall be allowed under this section in respect of an expenditure incurred for any purpose, which is an offence or is prohibited by law.

Explanation 2:- No deduction shall be allowed under this section in respect of an expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013.

UNIT B – SPECIFIC DISALLOWANCES

5.22 ADVERTISEMENT IN SOUVENIR, BROCHURE, PAMPHLET ETC. OF POLITICAL PARTY

Section:- 37(2B)

No allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

SECTION 80GGB AND 80GGC

5.23 AMOUNTS NOT DEDUCTIBLE

Section:- 40

Notwithstanding anything to the contrary in sections 30 to 38, the following amounts ***shall not be deducted*** in computing the income chargeable under the head "Profits and gains of business or profession".

5.23A INTEREST, ROYALTY, FEES FOR TECHNICAL SERVICES PAYABLE OUTSIDE INDIA OR PAYABLE TO NON-RESIDENTS

Section:- 40(a)(i)

In the case of any assessee—any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

A. outside India; or

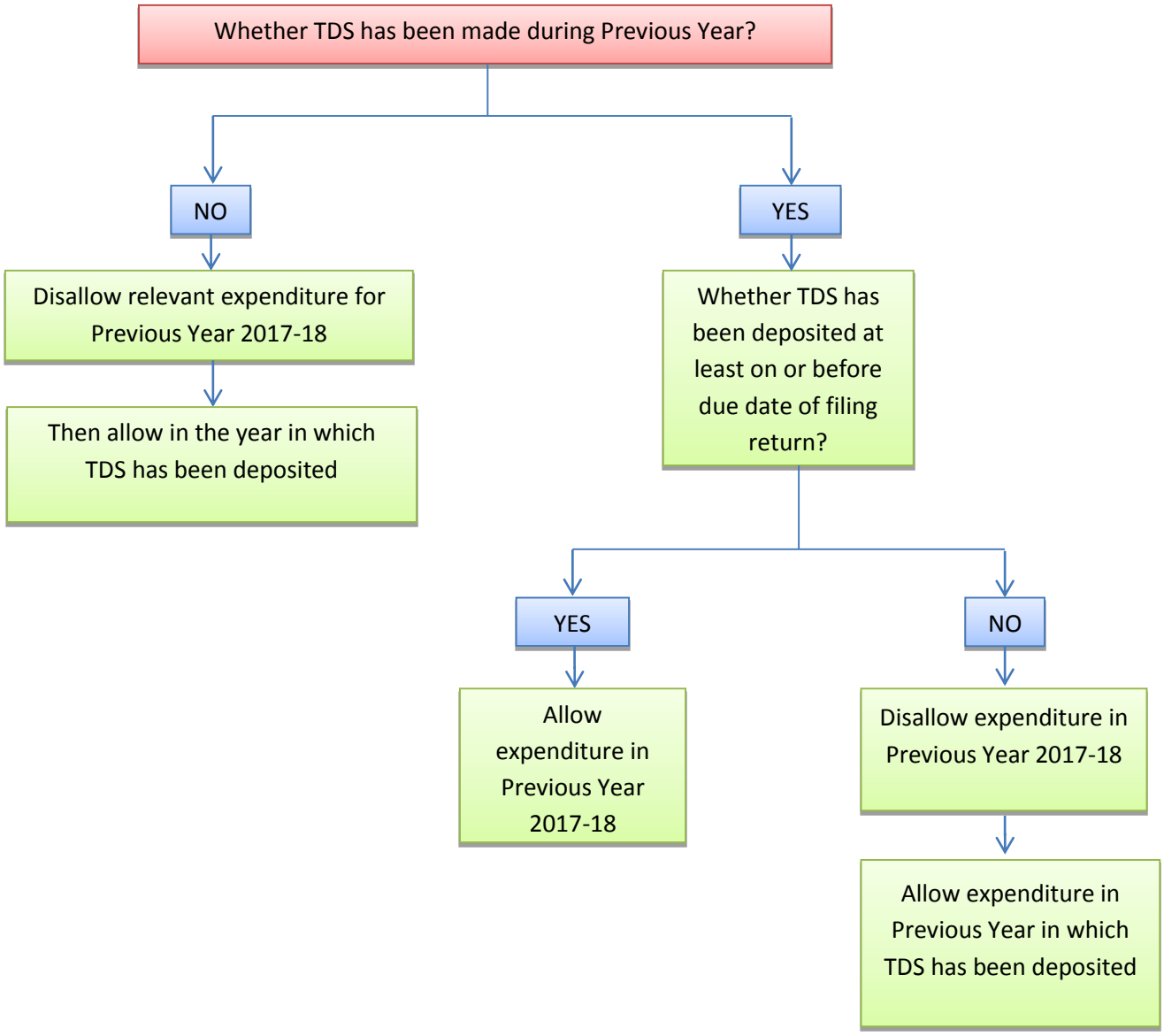
B. in India to a non-resident, not being a company or to a foreign company, on which tax is deductible at source under Chapter XVII-B (TDS Chapter) and

(i) such tax has not been deducted or,

(ii) after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under sub-section (1) of section 200 :

Provided *that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in 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.*

Summary :- Payment to Non-Resident other than Salary [Section 40(a) (i)]



Practical 27

Discuss tax consequences under section 40 (a) (i).

(a) A consultancy fees of Rs. 40,000 is credited by X Ltd. to the account of non-resident payee on **1st February, 2018** but tax was deducted on **April 1, 2018** and it is deposited on **May 2, 2018**. Due date of filing return for X Ltd. is **September 30, 2018**.

(b) Interest of Rs. 80,000 on debenture is paid by Y Ltd. on **January 10, 2018** to the account of non-resident payee. Tax is deducted on the same day. Tax is deposited on **August 10, 2018**. Due date of filing return for Y Ltd. is **September 30, 2018**.

(c) Suppose in point no.(b) above, tax is deposited on **October 10, 2018**.

Solution

(a) In this case, X Ltd failed to deduct TDS during previous year **2017-18**, therefore, consultancy fee of Rs. 40,000 shall be first disallowed for the previous year **2017-18** and same shall be allowed as deduction in the year in which TDS has been deposited i.e. in previous year **2018-19**.

(b) In this case, Y Ltd. has deducted TDS during previous year **2017-18** and further, same has been deposited on or before due date of filing return under section 139(1), therefore, interest of Rs. 80,000 paid to non-resident shall be allowed as deduction during previous year **2017-18** itself.

(c) In this case, Y Ltd. though deducted TDS during previous year **2017-18** but failed to deposit the same on or before due date of filing return under section 139(1), therefore, interest expense of Rs. 80,000 shall be first disallowed for the previous year **2017-18** and same shall be allowed as deduction in the year in which TDS has been deposited. i.e. in previous year **2018-19**.

Reader's Note:

5.23B | ANY SUM PAYABLE TO RESIDENT

Section:- 40(a)(ia)

30% of any sum payable to a resident on which tax is deductible at source under Chapter XVII-B and

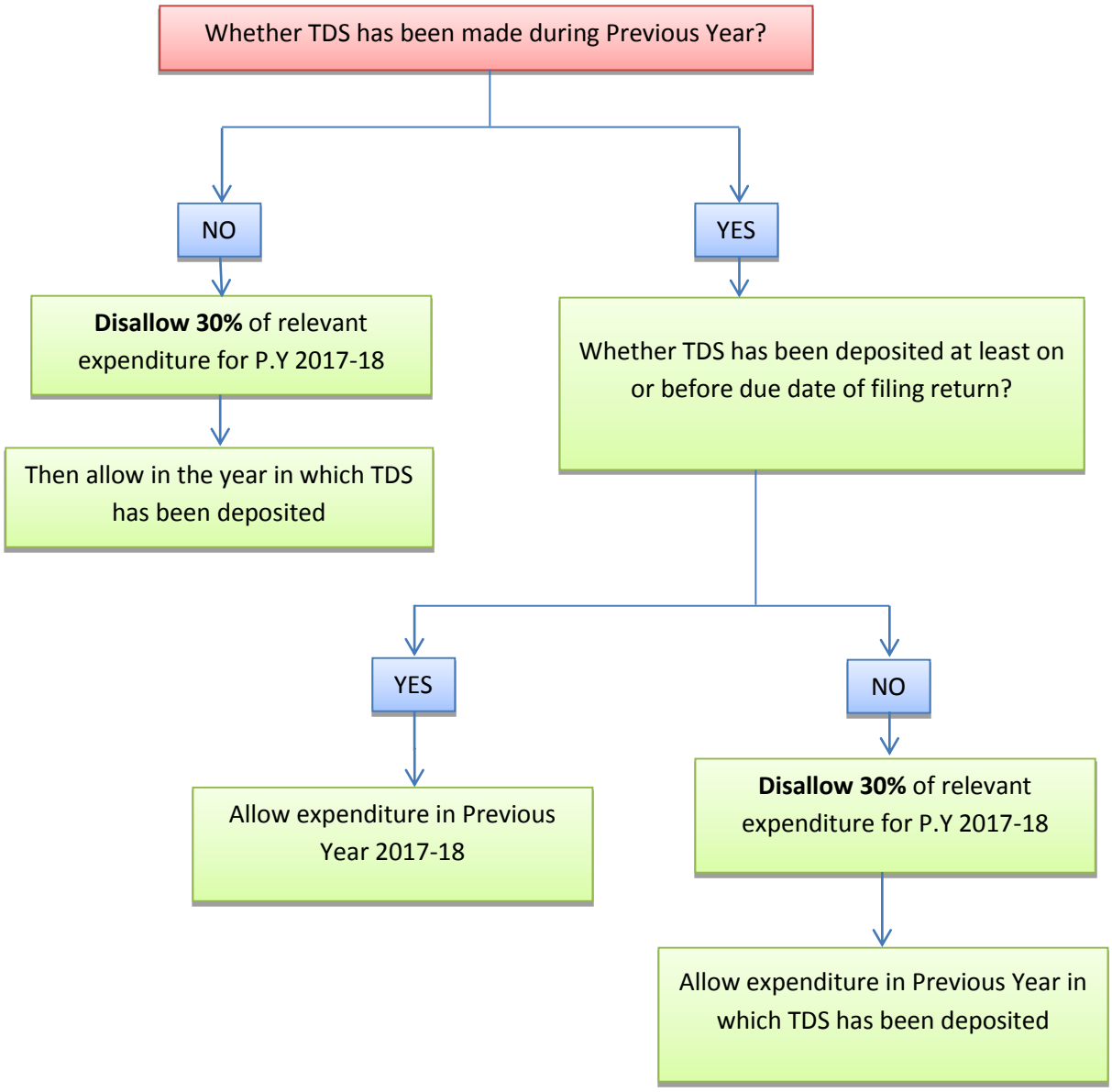
(i) such tax has not been deducted or,

(ii) 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 any subsequent year, or has been deducted during the previous year but paid 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."

Summary :- Any Payment to Resident [Section 40(a)(ia)]



Practical 28

Discuss tax consequences under section 40 (a) (ia).

(a) A consultancy fees of Rs. 40,000 is credited by X Ltd. to the account of resident payee on **1st February, 2018** but tax was deducted on **April 1, 2018** and it is deposited on **May 2, 2018**. Due date of filing return for X Ltd. is **September 30, 2018**.

(b) Interest of Rs. 80,000 on debenture is paid by Y Ltd. on **January 10, 2018** to the account of resident payee. Tax is deducted on the same day. Tax is deposited on **August 10, 2018**. Due date of filing return for Y Ltd. is **September 30, 2018**.

(c) Suppose in point no.(b) above, tax is deposited on **October 10, 2018**.

(d) Salary of Rs. 12,00,000 was paid to executive director (resident) of Z Ltd. during previous year **2017-18** without deducting TDS.

Solution

(a) In this case, X Ltd failed to deduct TDS during previous year **2017-18**, therefore, 30% consultancy fee of Rs. 40,000 (Rs. 12,000) shall be first disallowed for the previous year **2017-18** and same shall be allowed as deduction in the year in which TDS has been deposited i.e. in previous year **2018-19**.

(b) In this case, Y Ltd. has deducted TDS during previous year **2017-18** and further, same has been deposited on or before due date of filing return under section 139(1), therefore, interest of Rs. 80,000 paid to non-resident shall be allowed as deduction during previous year **2017-18** itself.

(c) In this case, Y Ltd. though deducted TDS during previous year **2017-18** but failed to deposit the same on or before due date of filing return under section 139(1), therefore, 30% interest expense of Rs. 80,000 (Rs.24,000) shall be first disallowed for the previous year **2017-18** and same shall be allowed as deduction in the year in which TDS has been deposited. i.e. in previous year **2018-19**.

(d) Considering the amendment made by Finance Act, 2014, section 40(a)(ia) is applicable to **any sum payable to resident** (which includes salary also). Since Z Ltd. had not deducted tax at source, it will attract disallowance of Rs. 3,60,000 (30% of Rs. 12,00,000) for the previous year **2017-18** while computing its income under head "Profits and gains from business or profession".

Reader's Note:

5.23C AMOUNT WHICH IS SUBLECT TO EQUALISATION LEVY

Section:- 40(a)(ib)

Any consideration paid or payable to a non-resident for a specified service on which equalisation levy is deductible, shall be disallowed, if such levy has not been deducted or after deduction, has not been paid on or before the due date under section 139(1) .

However such sum shall be allowed as a deduction in the previous year in which such levy has been paid.

5.23D INCOME TAX

Section:- 40(a)(ii)

Any sum paid on account of any rates or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits and gains. Further, any sum paid outside India and eligible for relief of tax under section 90 / 90A /91 is not deductible.

To sum up, Income tax including foreign income tax is not deductible.

5.23E WEALTH TAX

Section:- 40(a)(iia)

Any sum paid on account of wealth-tax under the Wealth-tax Act, 1957, or any tax of a similar nature chargeable under any law in force in any foreign country.

However, any tax chargeable with reference to the value of any particular asset of the business or profession" is not subject to disallowance.

5.23F CERTAIN PAYMENTS MADE BY STATE GOVERNMENT UNDERTAKING

Section:- 40(a)(iib)

Any amount paid by way of royalty, license fee, service fee, privilege fee, service charge or any other fee or charge (by whatever name called), which is levied exclusively on a State Government undertaking by the State Government – **Not Deductible**

Any amount which is appropriated (directly or indirectly) from a State Government Undertaking by the State Government - **Not Deductible**

5.23G SALARY PAYABLE OUTSIDE INDIA OR PAYABLE TO NON-RESIDENTS

Section:- 40(a)(iii)

In this case, verify that

(a) Either TDS has been deducted

OR

(b) TDS has been deposited

If any of the above (a) or (b) is satisfied then, allow salary expenditure in the previous year to which it pertains **(Previous year 2017-18).**

Practical 29

Fill in the last column considering the provisions of section 40(a)(iii) of Income Tax Act, 1961 assuming that payment is made by a company to (a) any person outside India or (b) non-resident in India –

Amount Rs. (Salary for the Previous year 2017-18)	Actual date of tax deduction	Actual date of tax deposit	Previous year in which salary payment is deductible
90,000	March 31, **2018**	April 7, **2018**	
1,60,000	March 31, **2018**	May 12, **2018**	
70,000	Not deducted	May 12, **2018**	
75,000	March 31, **2018**	Not deposited	
95,000	Not deducted	Not deposited	

Solution

Amount of Salary	Previous year in which salary payment is deductible
90,000	**2017-18**
1,60,000	**2017-18**
70,000	**2017-18**
75,000	**2017-18**
95,000	No deduction

Reader's Note:

5.23H | TAX ON NON-MONETARY PERQUISITES

Section:- 40(a)(v) and 10(10C)

(1) Any obligation of employee which has been met by employer is treated as perquisite and therefore it shall be added to the salary income of employee.

(2) On the basis of same reasoning, income tax liability of employee which has been met by employer shall be treated as perquisite and therefore added to salary.

(3) However, as per Section 10 (10CC) if income tax is borne by employer in respect of non-monetary perquisite, then such tax (though borne by employer) shall not be added to salary income.

(4) However there is a punishment to employer under section 40(a)(v). As per this section employer will not get deduction of tax so borne while computing his PGBP income.

Practical 30

Mr. Jabanz, an employee of Himmat Software Private Limited, provides following information:

(a) Salary : Rs. 50,000 p.m.

(b) Employer had taken unfurnished house property on monthly lease of Rs. 12,000 and provided the same to Mr. Jabanz as rent-free unfurnished accommodation,

(c) It was agreed that the tax on above perquisite is to be borne by employer

You are required to compute tax liability of Mr. Jabanz.

Further, discuss tax consequences of above transactions in the hands of Himmat Software Private Limited.

Solution

Computation of total income and tax liability in the hands of Mr. Jabanz

Particulars	Rs.
Salary	6,00,000
Value of rent free accommodation (15% of salary or lease rent paid whichever is lower)	90,000
Tax borne by Employer on rent- free accommodation [Exempt under section 10(10CC)]	NIL
Total Income	6,90,000
Tax on total income (A)	64,890
Average rate of tax (Rs. 64,890 / Rs. 6,90,000 x 100) :	9.4043%
Tax on perquisite (9.4043% of Rs. 90,000) (B)	(8,464)
Net Tax Payable (A-B)	**56,426**

Tax consequences of following payments in the hands of Himmat Software Private Limited:

Particulars	Rs.	Tax Treatment under head PGBP
Salary to Mr. Jabanz	4,80,000	Deductible under section 37(1)
Lease rent paid	1,20,000	Deductible under section 30/37(1)
Tax on perquisite borne by A Ltd.	8,464	Not deductible due to section 40(a)(v)

Reader's Note:

5.24 PAYMENTS MADE TO A RELATIVE ETC

Section:- 40A(2)

(1) Nature of payment

The payment is in respect of goods, services or facilities supplied / provided by a relative or specified person and the amount paid to such relative or specified person is considered to be excessive or unreasonable as compared with the market value of such goods, services or facilities, or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, then such excess shall be disallowed.

~~**Provided** that 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~~. **(This proviso not relevant from A.Y. 2017-18 and onwards – Amendment by Finance Act, 2017).**

(2) Specified persons

Specified persons for the purpose of this section are as under:

Sr. No.	Taxpayer who has incurred the expenditure	Person to whom payment is made
1.	An individual	To a Relative
2.	A company	To a person of the company or any relative of the director
3.	A firm	To a partner of the firm or a relative of a partner of the firm
4.	An association of persons	To a member of the association or a relative of the member
5.	Hindu undivided family	To a member of the family or a relative of such person
6.	Any taxpayer	To an individual who has substantial interest in the business of the taxpayer or relative of such individual.
7.	Any taxpayer	To a company which has a substantial interest in the business of the taxpayer, any director of such company or a relative of such director (or from the assessment year 2013-14, any other company carrying on business/profession in which the first mentioned company as a substantial interest)
8.	Any taxpayer	To a firm/ association of persons/ Hindu Undivided Family who has a substantial interest in the business of the taxpayer or partner/member of such person or a relative of partner/member

9.	Any taxpayer	To a company, one of whose directors has a substantial interest in the business of the taxpayer or payment is made to any director of such company or any relative of such director.
10.	Any taxpayer	To a firm/ association of persons/ HUF, one of whose partners/ HUF, one of whose partners/ members has a substantial interest in the business of the taxpayer or payment is made to any other partner/ member of such firm/ association/ HUF or any relative of such person
11.	An individual	To a person in whose business the taxpayer or any of his relative has a substantial interest
12.	Any company	To a person in whose business the taxpayer/any director of taxpayer/any relative of such director has a substantial interest.
13.	A firm/association of persons/ HUF	To a person in whose business the taxpayer/ any partner / member of the taxpayer or any relative of such partner / member has a substantial interest.

(3) Meaning of Relative

Relative in relation to an individual means, the husband, wife, bother, sister or any lineal ascendant or descendant of the individual.

(4) Substantial Interest

A person is said to have substantial interest in the business or profession if such person is the beneficial owner of at least 20% of equity capital or entitled to 20% of the profits of the concern at any time during the previous year.

Practical 31

Mr. Ram and Laxman are the directors of Ayodhya Limited td. Mr. Laxman holds 20% equity shares of Lanka Limited. During the concerned previous year, Lanka Limited made following payments to various persons.

(a) Lanka Limited purchased goods from Ayodhya Limited worth Rs. 1,08,000 (though market value of similar goods was Rs. 68,000 only)

(b) Lanka Limited procured technical services from Mr. Ram amounting to Rs. 52,000 (though market value of similar services costing Rs. 40,000 only

(c) Lanka Limited availed beauty treatment services for their staff members for celebration of "Annual day of Lanka Limited" from Ms. Sita (wife of Mr. Ram) costing Rs. 9,00,000 (though market value of similar services was Rs.5,00,000).

Solution

Sr. No. 9 above Table:

Where a taxpayer makes payment to a company, one of whose directors has a substantial interest in the business of the taxpayer or payment is made to any director of such company or any relative of such director.

Considering the abovementioned provisions, following disallowances shall be made under in the hands of Lanka Limited:

Payments made to	Relation	Amount to be disallowed under section 40A(2)
Ayodhya Ltd.	A company, one of whose director (Mr. Laxman) has a substantial interest in Lanka Limited	Rs. 40,000
Mr. Ram	Any director of Ayodhya Ltd.	Rs. 12,000
Ms. Sita	Relative of director	Rs. 4,00,000

Reader's Note:

5.25 PAYMENT EXCEEDING RS.20,000 MADE OTHERWISE THAN BY ACCOUNT PAYEE CHEQUE OR DEMAND DRAFT

Section:- 40A(3)

(1) Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account, exceeds twenty thousand rupees **(ten thousand rupees w.e.f. A.Y. 2018-19)**, no deduction shall be allowed in respect of such expenditure.

(2) With effect from 1st October, 2009, the monetary limit of Rs. 20,000 (Rs.10,000 w.e.f. A.Y. 2018-19) under Section 40A(3) has been raised to Rs. 35,000 in the case of payment made for plying, hiring or leasing goods carriages.

(3) The provisions of this section all types of expenditure including payment made for purchase of goods which are to be claimed under the head "PGBP".

(4) However, no disallowance shall be made this sub-section, 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.

(5) Circumstances prescribed under Rule 6DD, for which no disallowance shall be made under this section.

(a)	Payment made to the Reserve Bank of India or any banking company or State Bank of India or any subsidiary bank or any co-operative bank or land mortgage bank or any primary agricultural credit society or any primary credit society.
(b)	Payment made to Government and as per rules such payment is required to made in legal tender

(c)	Payment through banking system e.g. (i) any letter of credit (ii) a mail or telegraphic transfer (iii) book adjustment from any account in a bank to any other account in that or any other bank (iv) bill of exchange (v) The use of electronic clearing system through a bank account (vi) A credit card; (vii) A debit card.
(d)	where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;
(e)	**Where the payment is made for the purchase of—** (i) Agricultural or forest produce; or (ii) The produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or (iii) Fish or fish products; or (iv) The products of horticulture or apiculture, to the cultivator, grower or producer **of such articles, produce or products;** **Circular No. 4 /2006** It is further clarified that benefit under this clause will not be available on the payment for the purchase of livestock, meat, hides and skins from a person who is not proved to be the producer of these goods and is only a trader, broker or any other middleman by whatever name called. **Circular No. 8/2006** (a) The Board after examination of the issue is of the view that any person, by whatever name called, who buys animals from the farmers, slaughters them and then sells the raw meat carcasses to the meat processing factories or to the traders/retail outlets would be considered as producer of livestock and meat. (b) The benefit of rule 6DD of the Income-tax Rules, 1952 shall be available to the person referred to at para (a) above subject to furnishing of the following :— (i) A declaration from the person receiving the payment that he is a producer of meat; (ii) A confirmation that the payment, otherwise than by an account payee cheque or account payee bank draft, was made on his insistence; and (iii) A further confirmation from a veterinary doctor certifying that the person specified in the certificate is a producer of meat and that slaughtering was done under his supervision.
(f)	Where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g)	Where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;
(h)	Where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;
(i)	Payment made by an assessee by way of salary to his employee after deducting tax from salary in accordance with the provisions of section 192 and when such employee- a. is temporarily posted for a continuous period of 15 days or more in a place other than his normal place of duty or on a ship and b. does not maintain any account in any bank at such place or ship.
(j)	**Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;**
(k)	**Where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;**
(l)	Where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

Practical 32

From the following information, determine the amount of disallowance in the hands of ABC Limited.

1. Salary for the month of **January, 2018** paid to three employees namely:-Mahesh, Suresh and Ramesh in cash. (Cash payment made Rs.6,000, Rs.8,000 and Rs.22,500 respectively).
2. On **10th June, 2017**, ABC Limited purchased goods on credit from PQR Ltd. for Rs.54,000. This liability was discharged as under: -
   a. Rs.8,000 in cash on **15th June, 2017;**
   b. balance amount by a bearer cheque on **1st July, 2017.**
3. On **18th August, 2017,** ABC Limited incurred expenditure Rs.36,000 on machine repairing. However it made entire payment in cash on **21st September, 2017** as under:
   (a) Rs. 12,000 at 10 am
   (b) Rs. 10,000 at 3 pm
   (c) Rs. 14,000 at 6pm

4. On **18th November, 2017**, ABC Ltd. purchased packing material on credit from a relative of a director for Rs.48,000 though market value was Rs. 40,000. The amount was paid by way of bearer cheque on **22nd December, 2017**.

5. On **12th January, 2018**, ABC Ltd. made cash payment of Rs. 32,000 to transport operator, Mr. Bhola.

Solution

1. Rs.22,500 being payment made to Mr. Ramesh shall be disallowed.
2. Nothing will be disallowed out of the payment of Rs.8,000 in cash on **15th June, 2017**, as the payment does not exceed Rs.10,000. However, Rs.46,000 shall be disallowed since payment exceeds Rs.10,000 and payment has been made otherwise than by account payee cheque or draft.
3. Entire Rs. 36,000 shall be disallowed since aggregate payment made in a day to the same person exceeds Rs. 10,000 otherwise than by way of account payee cheque or draft.
4. **1st View:** Out of the payment of Rs.48,000, Rs.8,000 (being the excess payment to a relative) shall be disallowed under section 40A(2). Since the payment is made by bearer cheque (and not by an account payee cheque) and the remaining amount (i.e. Rs. 40,000) exceeds Rs.10,000, therefore, Rs.40,000 shall be disallowed under section 40A(3).

   2nd View: Entire Rs.48,000 shall be disallowed under section 40 A (3) since payment is made by bearer cheque and not an account payee cheque.
5. Nothing shall be disallowed out of payment made to Mr. Bhola since payment made to him does not exceed Rs. 35,000.

Reader's Note:

5.26 DEDUCTION HAS BEEN CLAIMED EARLIER ON DUE BASIS AND PAYMENT IS MADE SUBSEQUENTLY OTHERWISE THAN BY ACCOUNT PAYEE CHEQUE OR DRAFT

Section:- 40A(3A)

A special provision has been introduced to cover the above-mentioned payments under section 40A (3A) which is given below-

i. The taxpayer had claimed deduction in respect of an expenditure in any of the earlier years.
ii. The amount of deduction exceeds Rs. 20,000 (**Rs. 10,000 w.e.f. A.Y. 2018-19)**
iii. Subsequent year payment is made in respect of the aforesaid liability
iv. The payment exceeds Rs. 20,000 (**Rs. 10,000 w.e.f. A.Y. 2018-19)**
v. The payment is made otherwise than by an account payee cheque or draft or use of electronic clearing system through a bank account.

If above conditions are satisfied, the payment so made shall be deemed to be the business income of the previous year in which payment is made.

Practical 33

Tip Top Ltd. purchased goods worth Rs. 95,000 on credit from Mr. Mohan. This purchase was made on **10-07-2014.** However, Tip Top Ltd. discharged such liability on **10-8-2017** by cash payment. Discuss tax consequence of above transaction in the hands of TIP Top Ltd.

Solution

Provisions of section 40A(3A)

(i) Tip Top Ltd. had claimed deduction in respect of purchase in previous year **2014-15.**

(ii) The amount of deduction exceeds Rs. 10,000 (In this case, it is Rs. 95,000)

(iii) Subsequent year (In this case, previous year **2017-18**) payment is made in respect of the aforesaid liability.

(iv) The payment exceeds Rs. 10,000. (In this case, it is Rs. 95,000)

(v) The payment is made otherwise than by an account payee cheque or draft. (In this case, payment is made by way of cash)

If above conditions are satisfied, the payment so made (Rs. 95,000) shall be deemed to be the business income of the previous year **(2017-18)** in which payment is made.

Reader's Note:

5.27 PROVISION FOR PAYMENT OF GRATUITY TO EMPLOYEES

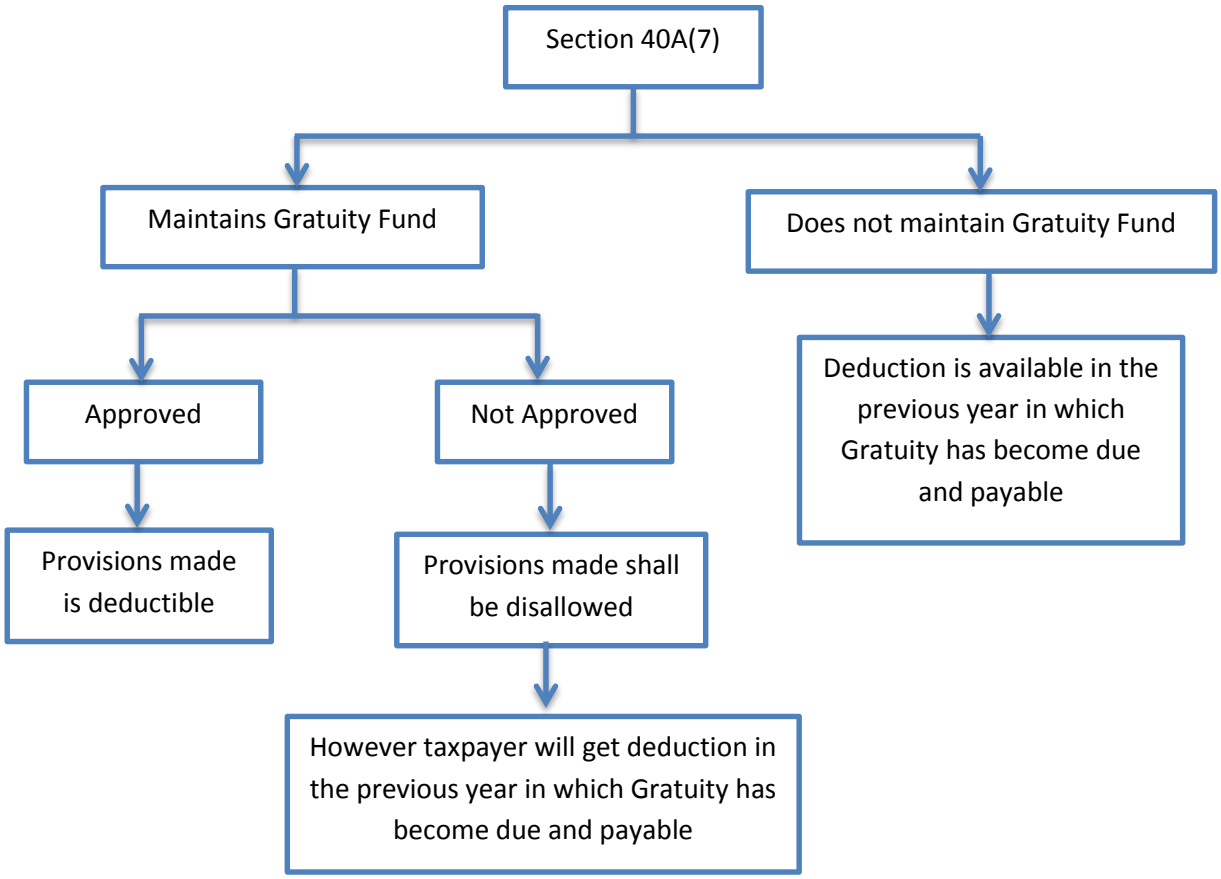
Section:- 40A(7)

Any provision for gratuity in the books of accounts shall not be allowed as a deduction unless

(a) the provision is made for any contribution towards an approved gratuity fund or

(b) the provision is for gratuity which has become due and payable during the previous year.

Readers shall also consider following summary:



Practical 34

Discuss the amount of deduction and year of deductibility in the following cases-

(a) Chicku Private Limited maintains an approved gratuity fund. It made a provision for gratuity amounting to Rs. 3,00,000 being the employer's contribution for the financial year **2017-18.**

(b) Mr. X retired on **29th March, 2018** from Tiku Private Limited which does not maintain gratuity fund. Gratuity of Rs. 6,00,000 was paid to Mr. X on **3rd April**, **2018**. Tiku Private made provision for the same in financial year **2017-18**.

Solution

(a) Chiku Private Limited is entitled to claim deduction of Rs. 3,00,000 in the previous year **2017-18** because it maintains approved gratuity fund.

(b) Tiku Private Limited is entitled to claim deduction of Rs. 6,00,000 in the previous year **2017-18** since it has become due and payable in the previous year **2017-18** itself and it had made requisite provision.

Reader's Note:

5.28 PAYMENT TO ANY UNRECOGNIZED WELFARE FUND

Section:- 40A(9)

Any contribution made by the assessee, as an employer to any unrecognized or non – statutory welfare fund is not allowable as deduction**.**

5.29 CERTAIN DEDUCTIONS TO BE ONLY ON ACTUAL PAYMENT

Section:- 43B

- Followings are deductible on payment basis:-
  - **(a)** Any sum payable by way of tax, duty, cess or fees by whatever name called under any law for the time being in force e.g. Municipal tax, Excise Duty, VAT, Service Tax, Custom Duty
  - **(b)** Any sum payable by an employer by way of contribution to provident fund or superannuation fund or any other fund for the welfare of employees. **(Employers' Contribution)**
  - **(c)** Any sum payable as bonus or commission to employees.
  - **(d)** Any sum payable as interest on any loan or borrowing from a public financial institution or a state financial corporation or a state industrial investment corporation.
  - **(e)** Interest on any loan or advances taken from a scheduled bank or **a co-operative bank other than a primary agriculture society or a primary co-operative agricultural and rural development bank. (bold portion inserted by Finance Act, 2017 w.e.f. A.Y. 2018-19)**
  - **(f)** Any sum payable by an employer in lieu of leave at the credit of his employee
  - **(g)** any sum payable by the assessee to the Indian Railways for the use of railway assets.
- Above expenditures are deductible in the previous year in which they have been incurred provided actual payment has been made on or before the due date for furnishing return of income u/s 139(1).

- If payment is not made within the time mentioned above, then relevant expenditure is first disallowed and thereafter it shall be allowed as deduction in the previous year in which actual payment is made.

- **Explanation 3C and 3D of section 43B**

  If any sum payable by an assessee as interest on any loan or borrowing or advance is converted by the bank or financial institution into a fresh loan, the interest so converted (but not actually paid) shall not be deemed to have been actually paid for the purpose of this section and therefore same shall not be allowed as deduction under the head PGBP. (Also consider problem no. 17 based on CBDT circular no. 7/ 2006.).

- Further, student must note that **Employees' Contribution** is not governed by section 43B. It is governed by section 2(24) and section 36(1) (va). Tax treatment of Employees' Contribution is as under:-

N.P. as per profit and loss account	XXX
Add: Employees' Contribution :- It is deemed income as per definition of Income [Section 2(24) (x)]	XXX
Less: Amount deposited within the due date under Provident Fund Act or any other relevant Act [Section 36(1)(va)]	XXX

Practical 35

Mr. Arun runs a manufacturing unit under proprietor concern named VARUNA PUMPS. The Profit and Loss Account of VARUNA PUMP for the year ending **March 31, 2018** is given below:

Particulars	Rs.	Particulars	Rs.
Manufacturing Cost	1,50,60,000	Sales	2,22,10,000
Excise Duty	20,00,500		
VAT	8,12,500		
Interest on Bank Loan	6,32,000		
Interest on unsecured loans from friends and relatives	3,01,000		
Employers' Contribution to Provident Fund	1,00,400		
Sales commission to agents	80,800		
Sales commission to employees	25,200		
Provision for leave salary	60,600		
Bonus	90,700		
Other Expenses	10,80,400		
Net Profit	**19,65,900**		
Total	**2,22,10,000**	**Total**	**2,22,10,000**

Other Information:

(1) The payment of excise duty is made as under:
- Rs.6,00,000 on **2nd September,2017**
- Rs.8,00,000 on **5th October,2017**
- Rs.4,00,000 on **31st March, 2017**
- Rs.1,00,000 on **4th April, 2017**
- Balance on **6th October, 2018**

(2) The payment of VAT is made as under:
- Rs.6,12,500 during the previous year **2017-18**
- Balance on **10th November, 2018**

(3) Out of interest on Bank loan, only Rs. 5,00,000 was paid. The payment is made as follows:
- Rs.3,00,000 during the previous year **2017-18**
- Rs.2,00,000 on **11th December, 2018.**

(4) Entire interest on loans from friends and relatives remain unpaid.

(5) The payment of Employers' Contribution to PF is made as under:
- Rs.60,000 paid within the due dates mentioned under PF Act
- Rs. 30,000 paid after the due dates under PF Act but during the previous year **2017-18**
- Balance paid on **3rd October, 2018**

(6) Employees' Contribution amounting to Rs. 1,13,500 reflected in current liability. Such liability is discharged as under:
- Rs.80,000 paid within the due dates mentioned under PF Act
- Rs. 20,000 paid after the due dates under PF Act but during the previous year **2017-18**
- Balance paid on **3rd April, 2018**

(7) Entire sales commission remain unpaid till the due date of filing return.

(8) Entire bonus was paid on **15th November, 2018**

(9) Nothing has been paid on account of provision for leave salary.

(10) During the previous year **2017-18**, the following payments are made in respect of expenses pertaining to earlier years:

(i) Bonus to employees pertaining to the previous year **2016-17** paid on **April 30, 2017** Rs.15,000;

(ii) Customs duty pertaining to the previous year **2009-10** paid on **April 10, 2017**: Rs.25,000;

(iii) Excise duty pertaining to the previous year **2013 -14** paid on **May 20, 2017**: Rs. 40,000; and

(iv) Leave salary payable to employees pertaining to the previous year **2013-14** paid on **December 2, 2017**: Rs. 45,000.

These payments do not pertain to the previous year **2017-18**. Consequently, these are not debited to Profit and Loss Account.

Find out the income under head "PGBP".

Solution

In this case, Mr. Arun is subject to tax audit under section 44AB, therefore due date for filing return is **30th September, 2018.** (This date is relevant for section 43B also).

Computation of income under head PGBP

Particulars	**Rs.**	**Reason for adjustment**
Net profit as per P & L account		
Add: Excise Duty	1,00,500	Not paid on or before due date of filing income tax return
Add: VAT	2,00,000	Not paid on or before due date of filing income tax return
Add: Bank Interest	1,32,000	Not paid at all
Add: Bank Interest	2,00,000	Not paid on or before due date of filing income tax return
Add : Interest on loan from friends and relatives	Nil	No adjustment required because such interest is not governed by section 43B
Add: Employers' Contribution to Provident Fund	10,400	Not paid on or before due date of filing income tax return
Add: Employees' Contribution	1,13,500	First of all employees' contribution is deemed to be the income as per definition of "Income" under section 2(24). And thereafter deduction is allowed under section 36(1)(va) as mentioned below.
Less: Deduction of employee's contribution	(80,000)	It is deductible under section 36(1)(iv). The only condition for claiming deduction is that it must be paid on or before due date under PF Act.
Add: Sales commission to agents	NIL	No adjustment required because sales commission to agents is not governed by section 43B
Add: Sales commission to Employees	25,200	Not paid on or before due date of filing income tax return
Add: Bonus to employees	90,700	Not paid on or before due date of filing income tax return
Add: Provision for leave salary	60,600	Not paid on or before due date of filing income tax return
Less: Bonus pertaining to previous year **2016-17**	Nil	No adjustment required since it was already allowed in previous year **2016-17** because it was paid within the due date of filing return for the previous year **2016-17**
Less: Custom duty pertaining to previous year **2009-10**	(25,000)	Since it was not allowed in previous year **2009-10**, therefore now allowed on payment basis under section 43B
Less: Excise duty pertaining to previous year **2013-14**	(40,000)	Since it was not allowed in previous year **2013-14,** therefore now allowed on payment basis under section 43B
Less: Leave salary	(45,000)	Since it was not allowed in previous year **2013-14**, therefore now allowed on payment basis under section 43B
Income under head PGBP	**7,42,900**	

Reader's Note:

Practical 36

Ramesh an individual, is engaged in manufacture of fertilizers. He is following mercantile system of accounting. He borrowed loans from Tamil Nadu Industrial Development Corporation and Indian Bank and has not paid interest as detailed below:

Sr. No.	Particulars	Rs.
(i)	Tamil Nadu Industrial Development Corporation **(P.Y. 2016-17 & 2017-18)**	15,00,000
(ii)	Indian Bank **(P.Y. 2017-18)**	30,00,000
		45,00,000

Both Tamil Nadu Industrial Development Corporation and Indian Bank, while rephasing the loan facilities of Ramesh during the year ended **31.3.2018**, converted the above outstanding interest due to them from Ramesh as a loan repayable in 30 equal instalments. During the year ended **31.03.2018,** Ramesh paid 4 instalments to Tamil Nadu Industrial Development Corporation and 3 instalments to Indian Bank.

Ramesh claimed the entire interest of Rs. 45,00,000 as an expenditure while computing the income from fertilizer business. Discuss whether his claim is valid and if not what amount of interest, if any, allowable, while computing the business income.

Solution

Deduction under section 43B

According to section 43B, any interest payable on the term loan to specified financial institutions and any interest payable on any loans and advance to scheduled banks shall be allowed only in the year of payment of such interest. If any sum payable by an assessee as interest on any loan or borrowing or advance is converted by the bank or financial institution into a fresh loan or borrowing or advance, the interest so converted and not 'actually paid', shall not be deemed as 'actual payment' and not allowed as deduction in the computation of income under section 43B.

In the given case of Ramesh, the unpaid interest of Rs. 15,00,000 due to Tamil Nadu Industrial Development Corporation (TIDCO) and Rs. 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Ramesh that the entire interest of Rs. 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction while computing the business income for the **F.Y.2017-18** shall be calculated as follows:

	Interest Outstanding	Number of Instalments	Amount per instalment	Instalments paid	Interest allowable (Rs.)
TIDCO	15 Lakh	30	50,000	4	2,00,000
Indian Bank	30 Lakh	30	1,00,000	3	3,00,000
Total amount eligible for deduction					**5,00,000**

Reader's Note:

UNIT C- DEEMED INCOME UNDER "PGBP"

5.30 SECTION 41

Sub - Section:- (1)

To whom it is applicable?	Particulars of deemed receipt
All assesses including **successor** of business	*Condition one* - In any of the earlier years, a deduction was allowed in respect of loss, expenditure or trading liability incurred by the assessee. *Condition two* - During the current previous year, the assessee— a. has obtained in cash or any other manner, any amount in respect of such loss, expenditure or trading liability (to be called refund or recovery); Or b. has obtained some benefit in respect of such trading liability by way of remission or cessation thereof [Explanation 1-"remission or cessation" for this purpose includes unilateral act of the assessee by way of writing off of such liability in his books of account]. If the above two conditions are satisfied, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to tax as the income of that previous year.

Practical 37

Discuss taxability of followings transactions in the hands of Ajanta Dyeing Limited (ADL).

(1) ADL recovered Rs. 35,000 from the ex-cashier on **10-05-2017** out of Rs. 1,00,000 which was embezzled by him on **14-08-2015.** ADL had claimed deduction of said Rs. 1,00,000 in the previous year **2015-16.**

(2) ADL obtained refund of custom duty Rs. 1,12,000 on **15-09-2017.** This custom duty was paid under protest and same was shown in balance sheet as "Recoverable from Custom Department".

(3) ADL had purchased raw material on credit from M/s. Texpin wivers amounting to Rs. 1,22,000 in the previous year **2014-15.** However, quality of raw material was not proper. Therefore, ADL paid only Rs.90,000 in the previous year **2017-18** and remaining amount has been written off in the books of accounts.

(4) Does your answer differ in Sr. No. 3 if Rs. 32,000 was not written off by the M/s Texspin Wivers in its books of accounts as bad debt?

Solution

Tax treatment of above transactions in the hands of Ajanta Dyeing Limited.

(1) Rs. 35,000 shall be taxed in the previous year **2017-18** under section 41(1).

(2) The refund of custom duty cannot be taxed because no deduction has been claimed for the same in earlier years.

(3) Rs.32,000 shall be taxed in the previous year **2017-18** under section 41(1).

(4) Answer will not differ in view of Explanation 1 to section 41(1).

Reader's Note:

5.31 SECTION 41

Sub - Section:- (2)

To whom it is applicable?	Particulars of deemed receipt
Undertaking engaged in generation or generation and distribution of power	**Lower** of the following shall be charged to tax as *balancing charge* in the year of transfer of asset of asset **a.** Surplus on transfer of asset **b.** depreciation already claimed by assessee

Refer Module III-Chapter 45-Depreciation–Unit D-Depreciation for Power Sector Units-Practical 27

5.32 SECTION 41

Sub - Section:- (3)

To whom it is applicable?	Particulars of deemed receipt
All assesses	**Lower** of the following shall be charged to tax on sale of capital assets used for scientific research and sold without having been used for other purposes, in the year of transfer of asset **a.** Surplus on transfer of asset **b.** Deduction already claimed by assessee under section 35.

Refer Module III - Chapter 45 - Depreciation – Unit B- Meaning of Actual Cost-Practical 10

5.33 SECTION 41

Sub-Section:- (4)

To whom it is applicable?	Particulars of deemed receipt
All assesses **excluding successor** of business	Bad debts earlier allowed which has been subsequently recovered shall be taxed in the previous year in which it has been recovered. **Note:-** ***Recovery after discontinuance of business or profession [Sec. 176(3A), (4)]*** - Where any business or profession is discontinued, any sum received after the discontinuance of the business or profession is deemed to be the income of the recipient and charged to tax in the year of receipt.

Refer Module I - Chapter 5 - Profit and Gains from Business or Profession - Practical 21

Practical 38

Mr. Shantnu runs proprietorship firm named " Mahabharat & Co." since 40 years. He claimed bad debt of Rs. 2,32,000 in previous year **2012-13.** Discuss taxability under following situations:

Situation (a) : Out of Rs.2,32,000, Mr. Shantnu recovered Rs.1,12,000 in previous year **2017-18.**

Situation (b) : Mr. Shantnu expired and his son Mr. Bhisma continued the business. Mr. Bhisma recovered Rs.1,12,000 out of Rs.2,32,000 in previous year **2017-18.**

Situation (c) : Mr. Shantnu expired but his son Mr. Bhisma has not continued the business. However, Mr. Bhisma recovered Rs.1,12,000 out of Rs.2,32,000 in previous year **2017-18.**

Solution

Situation (a)

Bad debt recovery of Rs. 1,12,000 shall be taxed in the hands of Mr. Shantnu under section 41(4) of the Act. This amount shall be taxed in the year of recovery i.e. previous year **2017-18.**

Situation (b)

Bad debt recovery of Rs. 1,12,000 shall be taxed in the hands of Mr. Bhisma under section 41(1) of the Act. This amount shall be taxed in the year of recovery i.e. previous year **2017-18.**

Situation (c)

Bad debt recovery of Rs. 1,12,000 shall be taxed in the hands of Mr. Bhisma under section 176(3A) of the Act. This amount shall be taxed in the year of recovery i.e. previous year **2017-18.**

Reader's Note:

5.34 SECTION 41

Sub - Section:- (4A)

To whom it is applicable?	Particulars of deemed receipt
Assesses covered by section 36(1)(viii)	Amount withdrawn from special reserve shall be taxed in the previous year in which such amount has been withdrawn.

Refer Module I - Chapter 5 - Profit and Gains from Business or Profession - Practical 25

5.35 SECTION 41

Sub - Section:- (5)

To whom it is applicable?	Carry forward of loss when business is discontinued
All assesses	The unabsorbed non-speculative loss pertaining to the year in which the business or profession is discontinued is allowed to be carried forward for indefinite period. Even return of income is not required to be filed within the time allowed under section 139(1) for this purpose. Thereafter, such loss is to be permitted to be set off only against deemed business income u/s. 41(1), (3), (4), (4A).

Practical 39

Mr. Ramesh closed down his grocery shop on **15-08-2002.** At that time, he has following unadjusted business losses from this business:

(a) Business loss of Rs. 40,000 pertaining to previous year **2000-2001.**

(b) He further incurred loss of Rs. 18,000 for the period commencing on **1st April, 2002** and ending on **15-08-2002**)

To his surprise, one of debt amounting to Rs. 38,000, for which he claimed deduction as bad debt in the previous year **2001-02,** was recovered on **10-09-2017.** Discuss tax consequences on bad debt recovery.

Solution

Particulars		Rs.
	Deemed Income under section 41(4)	38,000
Less:	Set off under section 41(5)	(18,000)
Income taxable under head PGBP for the P.Y. 2017-18		**20,000**

Reader's Note:

UNIT D-SPECIAL PROVISIONS UNDER "PGBP"

5.36 SPECIAL PROVISIONS IN THE COMPUTATION OF INCOME IN CASE OF BUSINESS OF PROSPECTING OR EXTRACTION OF MINERAL OIL

Section:- 42

(1) Applicability of this special provision

Any assessee carrying on business of prospecting for, extraction or production of mineral oil, petroleum and natural gas who has entered into an agreement with Central Government.

(2) Deduction under this section

The deductions or allowances specified in the agreement shall be claimed in addition to the allowances admissible under this Act, even if they are not accordance with the provisions of the Income Tax Act, 1961.

(3) Taxability in the event of transfer of such business or interest in the business

Situation I: Where the proceeds of transfer are less than expenditure remaining unallowed then the difference shall be allowed as a deduction in the previous year in which the business or interest is transferred.

Situation II: Where the proceeds of transfer exceeds the expenditure remaining unallowed the excess amount shall be chargeable to tax as profits and gains of the business of the previous year in which such business is transferred.

(4) Effect on amalgamation or demerger

In the event of amalgamation or demerger, the provisions of this section shall not apply to the amalgamating company / demerged company BUT it shall apply to the amalgamated company or resulting company as the case may be.

5.37 SPECIAL PROVISIONS CONSEQUENTIAL TO CHANGES IN RATE OF EXCHANGE OF CURRENCY

Section:- 43A

Where an assessee acquires an asset from abroad and in consequence of the variation in exchange rate, the liability of the assessee in terms of payment towards the acquisition of that asset increases or decreases, then the actual cost of that asset shall be increased or decreased for the following sections:

- Section 43(1)
- Section 35(1)(iv)
- Section 36(1)(ix)
- Section 48.

However, the abovementioned increase or decrease in liability due to exchange rate fluctuation shall be taken into account at the time of making payment, irrespective of method of accounting followed by the taxpayer.

Explanation 1.—In this section, —

(a) "rate of exchange" means the rate of exchange determined or recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;

(b) "foreign currency" and "Indian currency" have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999.

Explanation 2.—Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

Explanation 3.—Where the assessee has entered into a contract with an authorised dealer for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, to be added to, or deducted from, the actual cost of the asset or the amount of expenditure of a capital nature or, as the case may be, the cost of acquisition of the capital asset under this section shall, in respect of so much of the sum specified in the contract as is available for discharging the liability aforesaid, be computed with reference to the rate of exchange specified therein.

Practical 40

Nicholas Manufacturing Ltd. purchased a machinery (eligible for depreciation at 15%) on credit from Germany for Euro 1,00,000 on **08.09.2016**. The exchange rate on the date of acquisition was Rs.73. The assessee made payment on **08.10.2017** and for that he took a forward exchange for that exchange rate specified in the contract was Rs.77 per Euro. Compute depreciation for the previous year **2016-17** and **2017-18.** Ignore additional depreciation.

Solution

Computation of depreciation for the assessment years 2016-17 and 2017-18

	Rs.	Rs.
Cost of the asset [€1,00,000 x Rs.73]	73,00,000	
Less: Depreciation for the previous year **2016-17** @15%	10,95,000	**10,95,000**
WDV as on **1.4.2017**	62,05,000	
Add: Exchange rate difference u/s 43A [€1,00,000 x Rs.4]	4,00,000	
WDV for the previous year **2017-18**	66,05,000	
Depreciation @15% for the previous year **2017-18**	9,90,750	**9,90,750**
WDV as on **1.4.2018**	56,14,250	

Reader's Note:

5.38 COST OF ACQUISITION OF STOCK IN TRADE ACQUIRED UNDER SPECIAL CIRCUMSTANCES

Section:- 43C

Section	Mode of Acquisition	To whom provisions of section 43C applicable?	Special Cost of Acquisition
43C(1)	Amalgamation	Amalgamated company	Cost to the amalgamating company + Cost of improvement + expenses incurred wholly and exclusively in connection with transfer
43C(2)	Total partition of HUF or gift or will or irrevocable trust	Members of HUF, Donee or beneficiary under will or the trust	Cost to the previous owner + Cost of improvement + expenses incurred wholly and exclusively in connection with transfer on such transfer including the gift tax paid by donor

Remark: The above provision shall not apply to the stock-in-trade which has been converted out of capital asset.

Practical 41

X Co. Ltd. was amalgamated with Y Co. Ltd. on **30.04.2017**. X Co. Ltd. was engaged in real estate and whereas Y Co. Ltd. was engaged in manufacture of textile articles. Y Co. Ltd. on amalgamation altered its objects clause of Memorandum of Association, to carry on real estate business.

The stock in trade of X Co. Ltd. (being vacant lands) was taken over at Rs. 140 lacs by Y Co. Ltd. as against their original cost of Rs. 125 lacs to X Co. Ltd. for the purpose of amalgamation. Y Co. Ltd incurred Rs. 25 lacs towards development of those lands obtained on amalgamation. It sold the entire land for Rs.160 lacs during the year ended **31.03.2018**.

Determine the tax implication of the transaction in the hands of Y Co. Ltd. for the previous year **2017-18**.

Solution

The business income of Y Co. Ltd. on sale of such lands would be calculated as under -

Particulars	Rs.
Sale price (in the hands of Y Co Ltd)	160
Less: Cost of acquisition under section 43C, being the original cost to the amalgamating company, X Co. Ltd	(125)
Less: Cost of improvement (incurred by Y Co. Ltd)	(25)
Taxable business income chargeable in the hands of Y Co. Ltd	10

Reader's Note:

5.39 SPECIAL PROVISION IN CASE OF INCOME OF PUBLIC FINANCIAL INSTITUTIONS, PUBLIC COMPANIES, ETC.

Section:- 43D

Assessee	Nature of Income	Year of taxability
- Public Financial Institutions - Scheduled banks - **co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank) – Inserted by Finance Act, 2017** - State Financial Corporations - State Industrial Investment Corporations	Interest on advances categorized as 'Bad & Doubtful debts" as per the guidelines issued by RBI.	Year in which such interest is: (i) credited to P&L account or (ii) actually received by the assessee whichever is earlier

5.40 COMPUTATION OF INCOME OF INSURANCE BUSINESS

Section:- 44

Notwithstanding anything to the contrary contained in the provisions of the Income Tax Act, in case of an assessee carrying on business of insurance including any such business carried on by a mutual insurance company or co-operative society, shall be computed under the head Profits and Gains of Business or Profession in accordance with the rules contained in First Schedule of Income Tax Act.

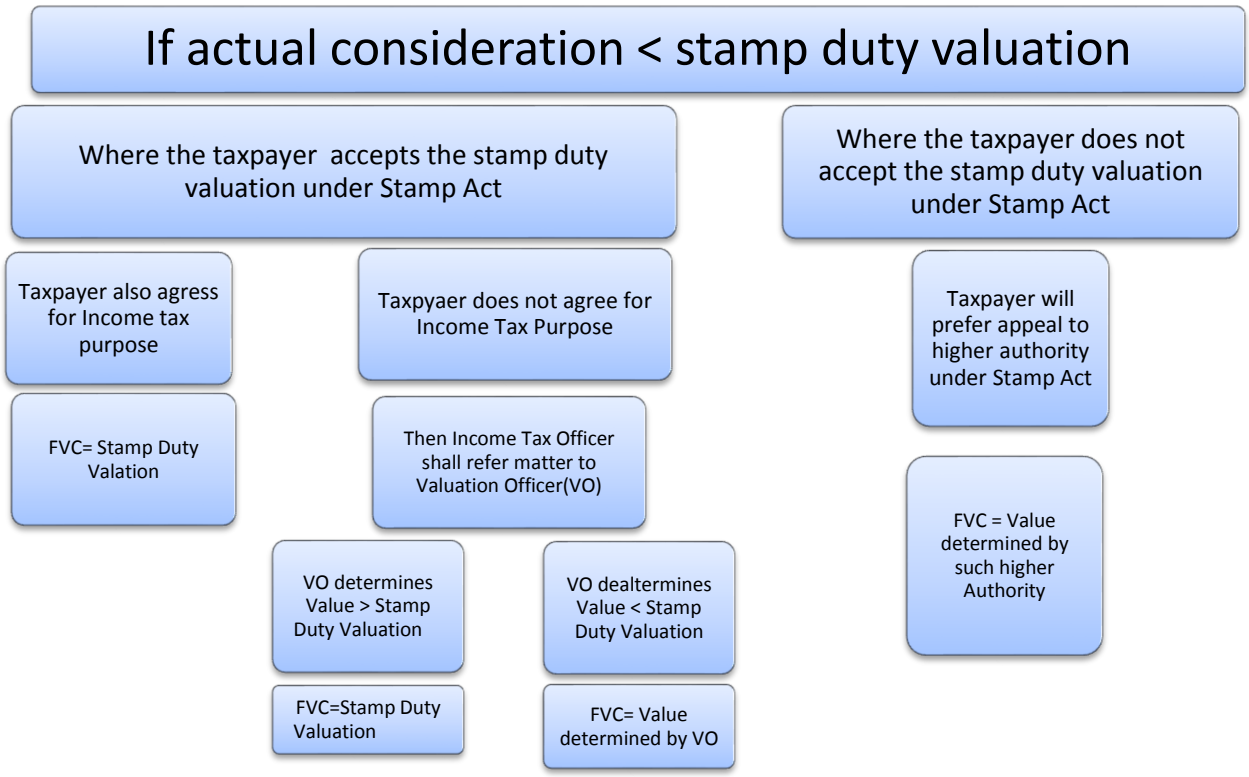
5.41 THE SPECIAL DEDUCTIONS IN CASE OF TRADE PROFESSIONAL OR SIMILAR ASSOCIATION

Section:- 44A

Refer Module II – Chapter 51 – Taxation of Mutual Concerns

5.42 STAMP DUTY VALUE OF LAND AND BUILDING TO BE TAKEN AS THE FULL VALUE OF CONSIDERATION IN RESPECT OF TRANSFER, EVEN IF THE SAME ARE HELD BY THE TRANSFEROR AS STOCK-IN-TRADE

Section:- 43CA and 50C



NOTE RELVENAT FOR SECTION 43CA:

As per sub-section (3) and (4) of Section 43CA, if there is a time gap between date of agreement and date of registration, **the stamp duty value may be taken as on the date of agreement** instead of the date of registration.

However, for the same, at least a part of the consideration has been received by any mode other than cash on or before the date of agreement.

NOTE RELVENAT FOR SECTION 50C (AS AMENDED BY FINANCE ACT, 2016):

As per first and second proviso to section 50 C(1) as inserted by Finance Act, 2016, if there is a time gap between the date of the agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration.

However, for the same, at least a part of the consideration has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of the agreement.

Now let's compare section 43CA and 50C

Particulars	Land and/or Building held as Business Asset (stock-in-trade)	Land and/or Building held as Capital Asset.
Taxability governed by?	Section 43CA [See Chart above]	Section 50C [See Chart above]
Whether option to adopt stamp duty value on date of agreement is available?	YES [See Note above]	**YES (Amendment by Finance Act, 2016) [See Note above]**

Practical 42

Rahul sold a building to Shweta, details of which are as under:

1. Date of entering into agreement: **1.8.2016**.
2. Agreed consideration : Rs. 100 lakhs
3. Down payment of Rs. 5 lakhs was received by bearer cheque on the date of agreement.
4. Stamp duty value of the building on the date of agreement was Rs. 135 lakhs.
5. On receipt of balance payment, registration of sale deed took place on **1.1.2017**.
6. Stamp Duty value on the date of registration of sale deed was Rs. 145 lakhs.
7. Rahul has purchased this building for Rs. 65 Lakh on **12.07.2015**.

Discuss tax implication in the hands of Rahul, if

Alternative 1: He is a property dealer.

Alternative 2: He is a Chartered Accountant.

Solution

Alternative 1: Rahul is a property dealer.

(1) Provision Applicable

- ✓ Section 43CA is applicable since building represents his stock-in-trade and
- ✓ Consideration charged is less than the stamp duty value on the date of registration.

(2) Computation of taxable business income

Particulars	Amount Rs. in lakhs	Remarks
Sale Consideration	135	As per Section 43CA(3)& (4), if there is a time gap between date of agreement and date of registration, **the stamp duty value may be taken as on the date of agreement** instead of the date of registration. However, for the same, at least a part of the consideration has been paid by any mode other than cash on or before the date of agreement.
Less: Purchase Price	65	-
Business Income	**70**	-

Alternative 2: Rahul is a Chartered Accountant.

(1) Provision Applicable

- ✓ Section 50C is applicable since building represents his capital asset and
- ✓ Consideration charged is less than the stamp duty value on the date of registration.

(2) Period of holding:

- ✓ Period of holding is from **12.07.2015 to 01.01.2017** (i.e., not exceeding 36 months)
- ✓ So the gain would be considered as short term capital gain.

(3) Computation of taxable capital gain

Particulars	Rs. in lakhs	Remarks
Sale Consideration	145	The amendment made by Finance Act, 2016 under section 50C gives an option to adopt stamp duty value on the date of registration **provided some consideration has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system** through a bank account, on or before the date of the agreement **Readers shall pay attention to the fact that Rahul received bearer cheque. Therefore, he cannot take advantage of above amendment.**
Less: Cost of Acquisition	65	-
Short Term Capital Gain	**80**	-

Reader's Note:

UNIT E - MAINTENANCE OF ACCOUNTS, PRESUMPTIVE TAXATION AND TAX AUDIT

5.43 PROVISIONS IN RELATION TO MAINTENANCE OF BOOKS OF ACCOUNTS UNDER INCOME TAX ACT

Section:- 44AA

The requirement of this section regarding maintenance of books of account by certain persons are based on two criteria:

(a) Financial criteria;

(b) Persons specified under Section 44AA (1).

Accordingly, the requirement of keeping books of account shall be as under:

Types of profession/Business	Financial criteria	Books of account / documents to be maintained
Specified professions u/s 44AA(1)	• Total gross receipts exceed Rs.1,50,000 in any of the three years immediately preceding the previous year **or** • where the profession is newly set up in the previous year, total gross receipts are likely to exceed Rs.1,50,000.	Books and documents as prescribed under Rule 6F (2).
Specified professions u/s 44AA (1)	• Total gross receipt Rs.1,50,000 or below in any of the three years	Such books of account and other documents as may enable the

	immediately preceding the previous year **or** • total gross receipts not likely to exceed Rs.1,50,000 in the previous year, if the profession is newly set up.	Assessing Officer to compute his total income in accordance with the provision of the Act.
Other persons	(a) Income from business or profession exceeds Rs.1,20,000 or total sales, turnover or gross receipts exceed Rs.10 lakhs in any of the three years preceding the previous year **or** (b) Where the business or profession newly set up in the previous year, if his income from business or profession likely to exceed Rs. 1,20,000 or total sales, turnover or gross receipts likely to exceed Rs.10 lakhs, **or** (c) **In case of person being an individual or Hindu undivided family, the provisions of clause (a) and (b) above, the limit of Rs. 1,20,000 shall be substituted by Rs. 2,50,000 and the limit of Rs. 10 lakhs shall be substituted by Rs. 25 lakhs (Inserted by Finance Act, 2017 w.e.f. A.Y. 2018-19) or** (d) where profits and gains from the business are claimed to be lower than profits computed under Section 44AE or 44BB or 44BBB or (e) Where the provisions of section 44AD(4) are applicable in his case and his income exceeds maximum amount not chargeable to tax in any previous year.	Such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provision of the Act.
Other persons	Not covered by above	Not required to maintain any books of account.

(1) Persons specified u/s 44AA (1): Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorized representative or film artist.

(2) Books and documents specified under Rule 6F: The books of account and other documents prescribed under Rule 6F(2) are:

(i) a cash book;

In cases where the cash book maintained by the assessee contains adequate particulars in respect of the expenditure incurred by him, it would not be necessary to prepare and sign the payment voucher.

(ii) a journal, if the accounts are maintained under mercantile system of accounting

(iii) a ledger;

(iv) for an amount exceeding Rs.25, carbon copies of bills, whether machine numbered or otherwise serially numbered, wherever such bills are issued by the assessee and carbon copies or counterfoils of machine numbered or otherwise serially numbered receipts issued by him;

(v) original bills wherever issued to the assessee and receipts in respect of expenditure incurred by the assessee or, where such bills and receipts are not issued and the expenditure incurred does not exceed Rs.50, payment vouchers prepared and signed by the assessee.

(3) In addition to the above books of account and other documents, under Rules 6F(3) a person carrying on medical profession shall also maintain the following:

(i) a daily case register in Form No.3C;

(ii) an inventory under broad heads, as on the first and the last day of the previous year, of the stock of drugs, medicines and other consumable accessories used for the purpose of his profession.

(4) The books of account and other documents specified above under rule 6F(2) and 6F(3) shall be kept and maintained for a period of 6 years from the end of the relevant assessment year.

5.44 PRESUMPTIVE TAXATION FOR ELIGIBLE ASSESSEE CARRYING ON ELIGIBLE BUSINESS

Section:- 44AD

(1) Eligible Assessee

– would mean an assessee who:

(i) is a resident, individual, Hindu undivided family or a partnership firm (limited liability partnership firm specifically excluded) and

(ii) has not claimed deduction under any of the sections 10AA and 80H to 80RRB.

(2) Eligible business means—

(i) any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE; and

(ii) whose total turnover or gross receipts in the previous year does not exceed an amount of **two crore rupees** (Amendment by Finance Act, 2016).

(3) Provisions of this section 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

(4) Presumptive Income

8% of the total turnover/ gross receipts or amount earned by the eligible assessee from such business whichever is higher.

However, the words "eight per cent", the words "six per cent" had been substituted, in respect of the amount of total turnover or gross receipts which is received by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account during the previous year or before the due date specified in sub-section (1) of section 139 in respect of that previous year. **(Inserted by Finance Act, 2017 w.r.e.f. A.Y. 2017-18)**

(5) Other salient features of this presumptive scheme

- **Section 44 AD(2):-** All the deductions under section 30 to 38 shall deemed to have been allowed. Due to deletion of proviso to this section, if eligible assessee is a firm then it cannot claim deduction in respect of interest and salary paid to partners. (Amendment made by Finance Act, 2016).
- **Section 44 AD(3) :-** The WDV of any asset shall be deemed to have been calculated as if the eligible assessee had claimed the deduction in respect of the depreciation for each of the relevant assessment years.
- **Section 44 AD(4):-** Where an eligible assessee declares profit for any assessment year in accordance with the provisions of this section and he declares profit for any of the five consecutive subsequent assessment years at lower than the required 8 percent, then he shall not be eligible to claim the benefit of the provisions of this section for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared up to 8 percent.
- **Section 44 AD(5):-** Consequently, such assessee, if total income exceeds maximum amount not chargeable to tax, shall be required to keep and maintain books of accounts and other documents as per section 44AA and get them audited and furnish a report of such audit as required under section 44AB.

Practical 43

M/s. Patel & Co., a partnership firm has opened medical store on **10-5-2017.** The firm purchased small furnished shop on **15-04-2017** for Rs. 45,00,000 (which includes Rs. 5,00,000 for furniture) Since it was the first year of operations, firm would like to opt for section 44AD of the Act. Following are the details of first year of operations:

Particulars	**Rs.**
Sales of Medicines (Cash Sales)	1,12,00,000
Less :	
Cost of goods sold	(1,03,00,000)
Depreciation as per section 32- shop	(4,00,000)
Depreciation as per section 32- furniture	(50,000)
Salary and interest to partners (as permitted by section 40(b)	(3,65,000)

Other shop expenses	(55,000)
Net profit	30,000
Income from other sources	10,000

You are required to compute total income of the firm for the assessment year **2018-19.**

Solution

Computation of Total income of Patel & Co. for the A.Y. 2018-19

Particulars	**Rs.**
Business income	8,96,000
Income from other Sources	10,000
Total Income	**9,06000**

Working Note: Calculation of presumptive income as per section 44AD

Particulars	**Rs.**
Turnover	1,12,00,000
Presumptive Income as per section 44AD (8% of Turnover)	**8,96,000**
Less: Salary and interest to partners	Not deductible
Net presumptive income under section 44AD	**8,96,000**

Other Notes:

1. Patel & Co. runs medical store and its turnover is less than Rs. 2 Crore, therefore, it is an eligible assessee under section 44AD of the Act.
2. As per the provisions of section 44AD of the Act, assessee has to declare minimum 8% of gross receipts as income under the head "PGBP", if firm would not like to maintain books of accounts.
3. Once firm opts for the section 44AD, all deductions under section 30 to 38 shall be deemed to have been allowed.
4. Further under section 44AD, firm cannot claim interest and remuneration paid to partners as well.

Reader's Note:

Practical 44

Continuing above problem, M/s. Patel & Co. offered its income under section 44AD for the **assessment year 2019-20** and **2020-21** also. However, for **assessment year 2021-22**, M/s. Patel & Co. decided to declare profit from the medical store lower than the 8% of turnover. Discuss the tax consequences of this decision and also find out the depreciation for the **assessment year 2021-22.**

Solution

As per section **44AD(4)** of the Act, where an eligible assessee declares profit for any assessment year in accordance with the provisions of this section and he declares profit for any of the five consecutive subsequent assessment years at lower than the required 8 percent, then he shall not be eligible to claim the benefit of the provisions of this section for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared up to 8 percent. Considering the above provision and the facts of present case, since Patel & Co. has declared profit under section 44AD for the **assessment year 2018-19,** ideally, it shall declare the profits under section 44AD of the Act for the following five assessment years:

Sr. No.	Assessment years
1	2019-20
2	2020-21
3	2021-22
4	2022-23
5	2023-24

However, Patel & Co. would like to declare profit from the medical store lower than 8% of turnover in **assessment year 2021-22,** then it shall not be eligible to claim benefit of section 44AD for the following five assessment years:

Sr. No.	Assessment years
1	2022-23
2	2023-24
3	2024-25
4	2025-26
5	2026-27

Consequently, Patel & Co. shall be required to keep and maintain books of accounts and other documents as per section 44AA and get them audited under section 44AB(e) for all the above years provided its total income exceeds exemption limit- **Section 44AD(5)**

As per the provisions of **section 44AD(3)**, the WDV of any asset shall be deemed to have been calculated as if the eligible assessee had claimed the deduction in respect of the depreciation for each of the relevant assessment years. Considering the requirement of this provision, Patel & Co. can claim depreciation on Shop and furniture for the assessment year **2021-22** as under:

Particulars	**Building (Rs.)**	**Furniture (Rs.)**
WDV as on **01-4-2017**	Nil	Nil
Add: Purchased during previous year **2017-18**	40,00,000	5,00,000
Less: Sold out during previous year **2017-18**	Nil	Nil
WDV for the previous year 2017-18	**40,00,000**	**5,00,000**
Less: depreciation for the previous year **2017-18**	(4,00,000)	(50,000)
WDV as on 01-04-18	**36,00,000**	**4,50,000**
Less: Depreciation for the previous year **2018-19**	3,60,000	45,000
WDV as on 01-04-19	**32,40,000**	**4,05,000**
Less: Depreciation for the previous year **2019-20**	3,24,000	40,500
WDV as on 01-04-2020	**29,16,000**	**3,64,500**
Less: Depreciation for the previous year **2020-21 (A.Y. 2021-22)**	**2,91,600**	**36,450**

Reader's Note:

Practical 45

Mr. Sanjay is engaged in the business of Civil Construction undertakes small government projects. He received the following amounts by way of contract receipts:

Particulars	Rs.
Towards contract work for supply of labour	70,00,000
Value of materials supplied by Government	10,00,000
Gross receipts	80,00,000

Mr. Sanjay paid Rs. 50,00,000 to labourers in cash. He has brought forward loss and unabsorbed depreciation of the discontinued business Rs.45,000 and Rs. 30,000 respectively. Compute income under the head "PGBP" assuming that he opts for section 44AD.

Solution

Particulars	Rs.
Presumptive income under section 44AD [Rs. 70,00,000 x 8%]	5,60,000
Less: unabsorbed depreciation	Nil
	5,60,000
Less: Business loss brought forward u/s 72	(45,000)
Business Income	5,15,000

Notes:

(1) As per para **31.1** of the **circular no. 684 of CBDT dated 10-06-1994,** gross receipts are the amount received from the clients for contract and will not include the value of material supplied by the client.

(2) Once assessee opts for section 44AD, deduction under section 30 to 38 shall be deemed to have been allowed. Therefore, question of disallowance in respect of labour payment of Rs. 50,00,000 in cash under section 40 A(3) does not arise.

(3) Once assessee opts for section 44AD, deduction under section 30 to 38 shall be deemed to have been allowed. Since depreciation is governed by section 32(2), it cannot be adjusted while computing income under section 44AD of the Act. But brought forward business loss is governed by section 72, same shall be adjusted against presumptive income computed under section 44AD.

Reader's Note:

5.45 PRESUMPTIVE TAXATION FOR ASSESSEE ENGAGED IN BUSINESS OF PLYING, HIRING AND LEASING GOODS CARRAIGES

Section:- 44AE

(1) Eligible assessee:

Eligible assessee would mean an assessee engaged in business of plying, hiring and leasing goods carriages and not owning more than 10 goods carriages at any time during the previous year

(2) Presumptive Income

The profits and gains from each goods carriage shall be Rs.7,500 for every month or part of a month during which the goods carriage is owned by the assessee in the previous year or an amount actually earned from the vehicle, whichever is higher

(3) Other salient features of this presumptive scheme

- All the deductions under section 30 to 38 shall deemed to have been allowed.
- If eligible assessee is a firm then it can claim deduction in respect of interest and salary paid to partners subject to the conditions and limits specified under section 40(b)..
- The WDV of any asset shall be deemed to have been calculated as if the eligible assessee had claimed the deduction in respect of the depreciation for each of the relevant assessment years.
- An assessee opting for the above scheme shall be exempted from maintenance of books of accounts related to such business as required under section 44AA of the Income-tax Act.
- Where an eligible assessee declares lower profits than the profits required under this section, then he shall be required to keep and maintain books of accounts and other documents as per section 44AA and get them audited and furnish a report of such audit as required under section 44AB.
- An assessee, who is in possession of a goods carriage, whether taken on hire purchase or on instalments and for which the whole or part of the amount payable is still due, shall be deemed to be the owner of such goods carriage.

Practical 46

Mr. Jambaz owns 12 heavy trucks throughout the previous year **2017-18**. All the trucks were purchased under "Hire Purchase" system. Out of 12 trucks, installments of 9 trucks were fully paid up and while for remaining 3 trucks installments are still due. Since, Mr. Jambaz became the owner of only 9 trucks during the previous year **2017-18**, he wants to opt for the presumptive taxation under section 44AE. Advice Mr. Jambaz.

Solution

As discussed above, an assessee, who is in possession of a goods carriage, whether taken on hire purchase or on instalments and for which the whole or part of the amount payable is still due, shall be deemed to be the owner of such goods carriage.

Therefore, Mr. Jambaz owns 12 trucks during the previous **2017-18.** Therefore, he is not eligible to opt for the presumptive taxation under section 44AE.

Reader's Note:

Practical 47

M/s. Chhabada & Co., a partnership firm is engaged in the business of plying goods carriages. On **1st April, 2017**, it owns 10 trucks. **On 2nd May, 2017**, firm sold one of the trucks and purchased another truck on **6th May, 2017.** This new truck could however be put to use only on **15thJune, 2017**.

Compute the total income of M/s. Chhabada & Co. for the assessment year **2018-19**, taking note of the following data:

Particulars	Rs.
Freight charges collected	13,70,000
Less :	
Operational expenses	(6,25,000)
Depreciation as per section 32	(1,85,000)
Salary and interest to partners [as permitted by section 40(b)]	(5,00,000)
Other office expenses	(15,000)
Net profit	45,000
Income from other sources	70,000

Solution

Computation of Total income of Chhabada & Co. for the A.Y. 2018-19

Particulars	Total Income, if books are not maintained	Total Income, if books are maintained and audited
Income from business of plying goods carriages	4,07,500 [Refer Notes]	45,000
Income from other sources	70,000	70,000
Total Income	9,77,500	1,15,000

Working Note: Calculation of presumptive income as per section 44AE

Particulars	No. of months	Rate per month	Amount (Rs.)
9 trucks – held throughout the year	12	7,500	8,10,000
1 truck – held up to 2nd May	2	7,500	15,000
1 truck– held from 6th May	11	7,500	82,500
Presumptive Income as per section 44AE			**9,07,500**
Less: Salary and interest to partners (as permitted by section 40(b)			(5,00,000)
Net presumptive income under section 44AE			**4,07,500**

Other Notes:

1. M/s. Chhabada & Co., does not own more than 10 trucks at any time during the previous year Therefore, it is an eligible assessee under section 44AE of the Act.
2. As per the provisions of section 44AE of the Act, assessee has to declare minimum monthly income of Rs. 7,500 per truck per month or part of a month.
3. Once firm opts for the section 44AE, all deductions under section 30 to 38 shall be deemed to have been allowed.
4. Further under section 44AE, it can claim interest and remuneration paid to partners.

Reader's Note:

5.46 PRESUMPTIVE TAXATION FOR ASSESSEE ENGAGED IN SPECIFIED PROFESSION

Section:- 44ADA

(1) Eligible Assessee

Eligible assessee – would mean a resident assessee who is engaged in specified profession [under section 44AA(1)] and whose total gross receipts do not exceed Rs. 50 lakh in a previous year

(2) Presumptive Income

50% of the total gross receipts or amount earned by the eligible assessee from such profession whichever is higher.

(3) Other salient features of this presumptive scheme

- All the deductions under section 30 to 38 shall deemed to have been allowed.
- If eligible assessee is a firm then it cannot claim deduction in respect of interest and salary paid to partners.
- The WDV of any asset shall be deemed to have been calculated as if the eligible assessee had claimed the deduction in respect of the depreciation for each of the relevant assessment years.
- Where an eligible assessee declares lower profits than the profits required under this section and whose total income exceeds maximum amount not chargeable to tax, then he shall be required to keep and maintain books of accounts and other documents as per section 44AA and get them audited and furnish a report of such audit as required under section 44AB.

Practical 48

Thakker & Co., a firm of chartered accountants following information:

Particulars	Rs.
Gross Receipts	48,00,000
Salary and interest to partners [as permitted by section 40(b)]	(12,00,000)
Salary to employees	(8,00,000)
Depreciation	(6,00,000)
Other expenses	(5,00,000)
Net profit of the firm	**17,00,000**

Determine the total income of Thakker & Co. for the assessment year **2018-19** assuming that income from other sources is Rs. 40,000 and the firm is eligible for a deduction of Rs. 5,000 under section 80G.

Solution

Computation of Total income of Thakker & Co. for the A.Y. 2018-19

Particulars	Total Income, if books are not maintained	Total Income, if books are maintained and audited
Income from profession	24,00,000 [Refer Notes]	17,00,000
Income from other Sources	40,000	40,000
Gross Total Income	**24,40,000**	**17,40,000**
Less: Deduction under section 80 G	(5,000)	(5,000)
Total Income	**23,35,000**	**17,35,000**

Working Note: Calculation of presumptive income as per section 44ADA

Particulars	Amount in Rs.
Gross Receipts	48,00,000
Presumptive Income as per section 44ADA (50% of Gross Receipts)	**24,00,000**
Less: Salary and interest to partners	Not deductible
Net presumptive income under section 44ADA	**24,00,000**

Other Notes:

1. Thakker & Co., is a firm of chartered accountants and gross receipts for the relevant previous year does not exceed Rs. 50 Lacs. Therefore, it is an eligible assessee under section 44ADA of the Act.
2. As per the provisions of section 44ADA of the Act, assessee has to declare minimum 50% of gross receipts as income under the head "PGBP", if firm would not like to maintain books of accounts.
3. Once firm opts for the section 44ADA, all deductions under section 30 to 38 shall be deemed to have been allowe
4. Further under section 44ADA, firm cannot claim interest and remuneration paid to partners as well.

Reader's Note:

5.47 TAX AUDIT

Section:- 44AB

(1) Applicability of this provision:

Section 44AB prescribes accounts to be audited in following five situations:-

Clause No.	Situation giving rise to tax audit
(a)	Every person carrying on business shall, if his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds one crore rupees in any previous year;
(b)	Every person carrying on profession shall, if his gross receipts in profession exceed **twenty-five (fifty – Amendment by Finance Act, 2016)** lakh rupees in any previous year; or
(c)	Every person 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 44AE or section 44BB or section 44BBB, as the case may be, and **he has claimed his income to be lower than the profits** or gains **so deemed** to be the profits and gains of his business, as the case may be, in any previous year;
(d)	Every person carrying on the profession shall, if the profits and gains from the profession are deemed to be the profits and gains of such person under **section 44ADA and he has claimed such income to be lower than the profits** and gains **so deemed** to be the profits **and** gains of his profession **and his total income exceeds the maximum amount which is not chargeable** to income-tax in any previous year; **(modified by Finance Act, 2016)**

(e)	Every person carrying on the business shall, if the provisions of **sub-section (4) of section 44AD** are applicable in his case and **his total income exceeds the maximum amount** which is **not chargeable to** income-**tax** in any previous year.
1st Proviso	However, this section shall not apply to the persons, who declares profits and gains for the previous year in accordance with the provisions of section 44AD(1) and his total sales, turnover or gross receipts, as the case may be, in business does not exceed two crore rupees in such previous year **(inserted by Finance Act, 2017 w.r.e.f A.Y. 2017-18)**

Practical 49

Mr. Ramesh runs grocery shop. Total turnover of this grocery shop for the previous year **2017-18** is Rs. 1 Cr and 45 Lacs. He would not like to opt for the provisions of section 44AD. He regularly maintains books of accounts. Due to loss under head house property and the deductions under section 80C to 80 U, total income of Mr. Ramesh for the previous year **2017-18** is Rs. 2,30,000. Whether he is required to get his accounts audited? If yes, then under which clause?

Solution

Consider following press release issued by the CBDT dated 20th June, 2016 giving clarification on "Threshold Limit of tax audit under section 44AB and section 44AD":

- Section 44AB of the Income-tax Act ('the Act') makes it obligatory for every person carrying on business to get his accounts of any previous year audited if his total sales, turnover or gross receipts exceed one crore rupees.
- However, if an eligible person opts for presumptive taxation scheme as per section 44AD(1) of the Act, he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed two crore rupees.
- The higher threshold for non-audit of accounts has been given only to assessees opting for presumptive taxation scheme under section 44AD.

Considering the above press release, 1st proviso to section 44AB of the Act as inserted by Finance Act, 2017 and the fact that Mr. Ramesh would not like to opt for section 44AD, he is advised to get his accounts audited under **clause (a) section 44AB** of the Act since turnover of grocery shop exceeded Rs. 1 Cr irrespective of his total income.

Reader's Note:

Practical 50

Mr. Kishore owns 5 heavy trucks throughout the previous year **2017-18**. He wants to declare business income of Rs. 2,45,000 from truck operations. Income from other sources is Rs.5,000. He wants to claim deduction of Rs. 30,000 u/s 80C. Advice Mr. Kishore for maintaining books of accounts and getting them audited.

Solution

In this case, Mr. Kishore wants to declare income from truck operation Rs.2,45,000 which is less than the income required to be disclosed under section 44AE (i.e., 5 x Rs.7500 x 12 = Rs. 4,50,000). Therefore,

he must maintain books of accounts and get the same audited under section 44AB(c) irrespective of his total income.

Reader's Note:

Practical 51

Mr. Utsav is a chartered accountant. He practices in individual name. For the previous year **2017-18**, his gross receipts from the profession was Rs. 9,00,000. He wants to declare Rs. 2,55,000 net income from this profession. Further, he earned interest on fixed deposit Rs. 5,000. He wants to claim deduction Rs. 30,000 u/s 80C. Advise him about getting his accounts audited in view of requirements of Section 44AB (d) of the Act.

Solution

In this case, Mr. Utsav wants to declare Rs.2,55,000 from his profession which is less than 50% of gross receipts (Rs.9,00,000 in this case).

Computation of Total Income of Mr. Utsav

Particulars		Rs.
	Income from profession	2,55,000
Add:	Income from other Sources	5,000
	Gross Total Income	**2,60,000**
Less:	Deduction under section 80C	(30,000)
Total Income		**2,30,000**

Since total income of Mr. Utsav does not exceed exemption limit, therefore, he is not required to get his accounts audited in view of the requirements of section 44AB(d) of the Act even though he would like to declare income from profession lower than 50% of gross receipts.

Reader's Note:

Practical 52

Does your answer differ in above problem, if income from other sources was Rs.40,000 instead of Rs.5,000.

Solution

Computation of Total Income

Particulars		Amount in Rs.
	Business Income	2,55,000
Add:	Income from other Sources	40,000
	Gross Total Income	**2,95,000**
Less:	Deduction under section 80C	30,000
Total Income		**2,65,000**

Since total income of Mr. Utsav exceeded exemption limit, therefore, he is required to get his accounts audited under section 44AD(d).

Reader's Note:

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(2) Audit

The audit shall be conducted by an accountant as explained u/s. 288 of the Income Tax Act

(3) Specified date for furnishing report

On or before due date of filing return under section 139 (1) of the Act.

(4) Forms of report

Nature of Person	**Audit Report**	**Statement of Particulars**
In case of a person who carries on business or profession and who is required to get his accounts audited under any law	Form 3CA	Form 3CD
In case of person who carries on business or profession but not being a person referred to above.	Form 3CB	Form 3CD

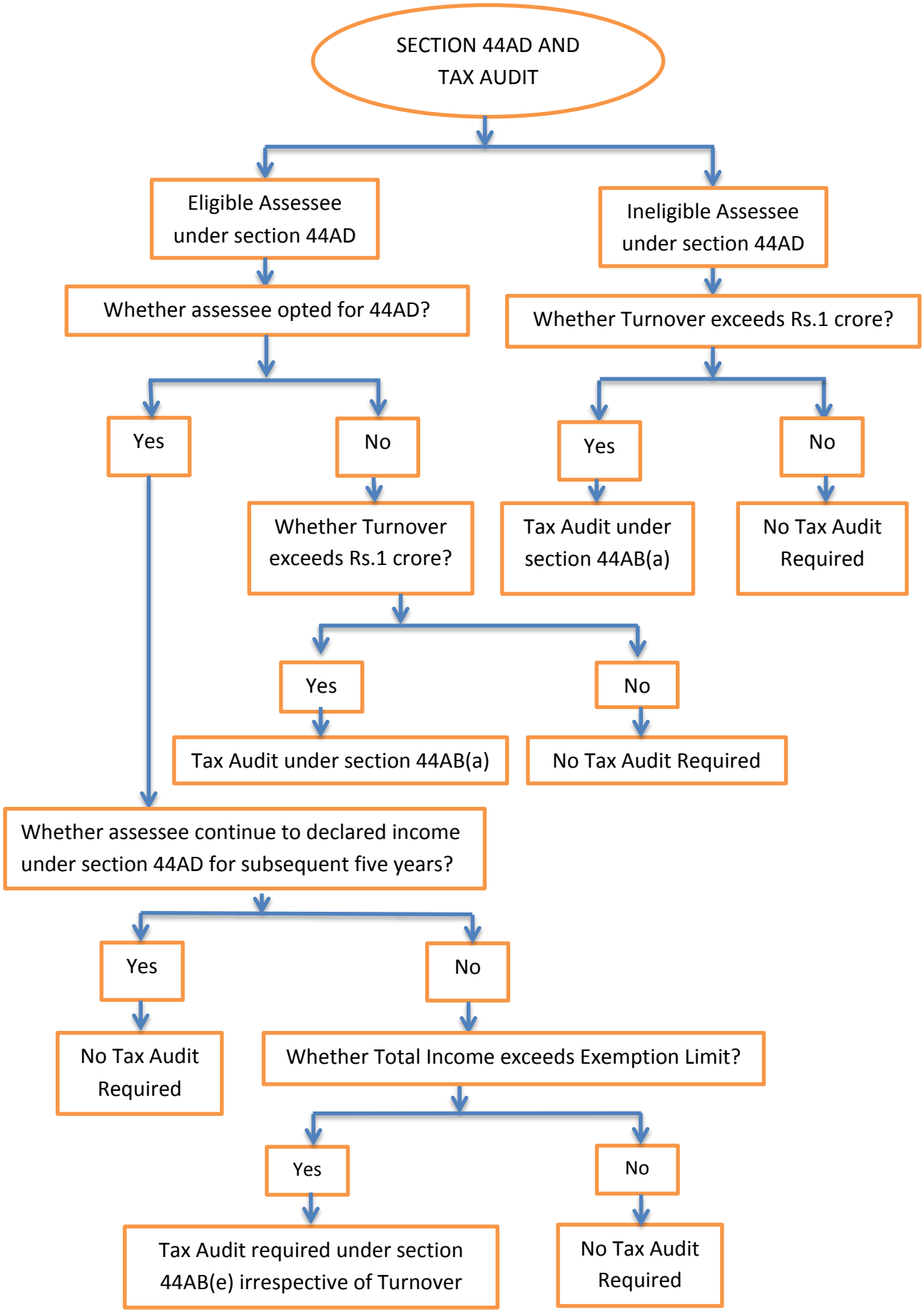
(5) Consequence of non – compliance

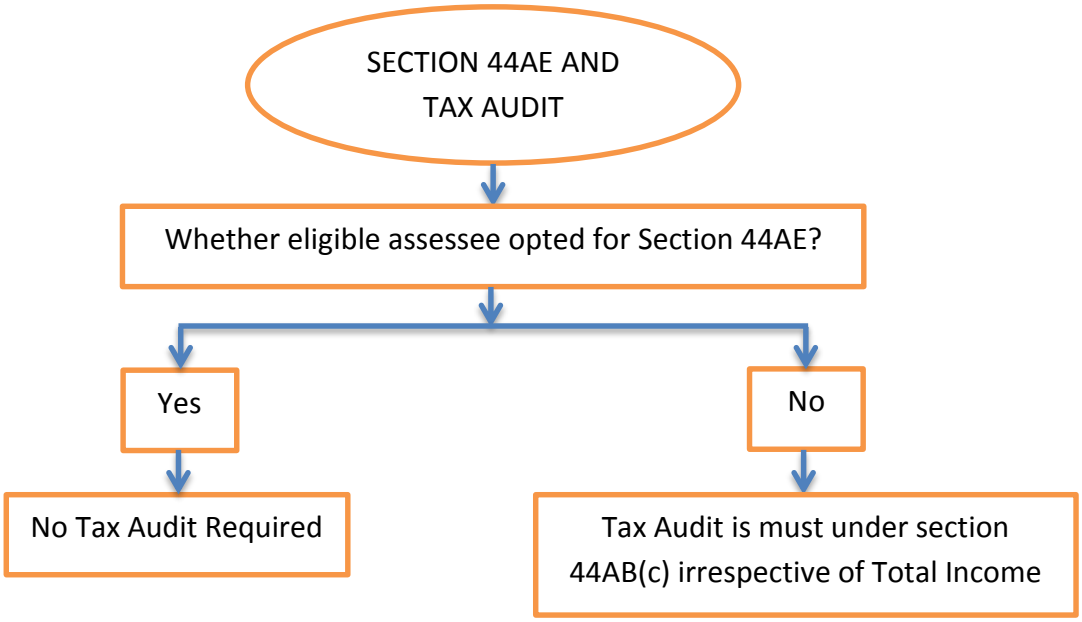
Failure to

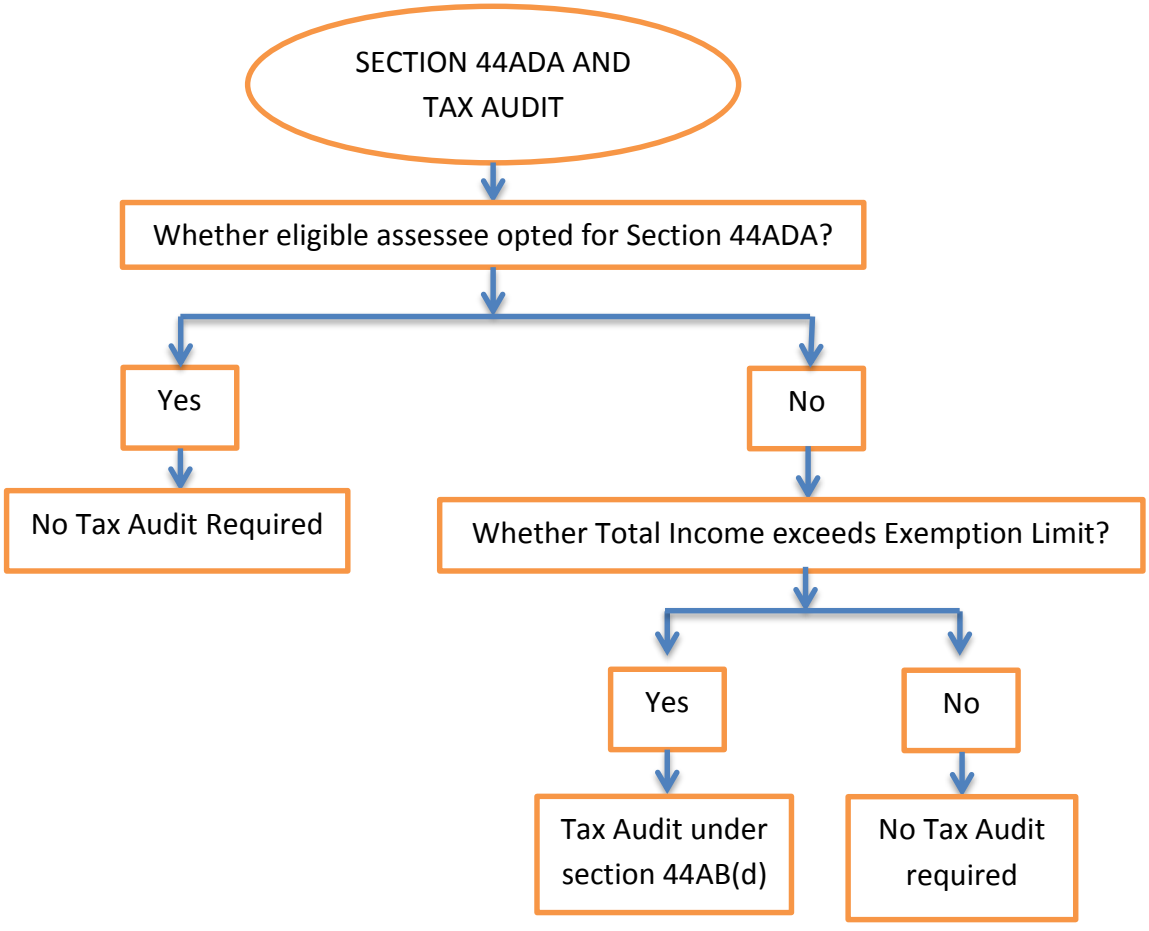
1) get accounts audited;
2) obtain a audit report as required u/s. 44AB;
3) furnish the said report before the due date;

then, the assessee is liable to pay a penalty @ 0.5% of the gross turnover / receipts or Rs.1,50,000/- whichever is less. **[Section 271B].**

To sum up presumptive taxation and tax audit, consider following:







Whether deduction of interest and remuneration to partner shall be allowed out of presumptive income?

Section 44AD	Section 44AE	Section 44ADA
No	Yes	No

5.48 PRESUMPTIVE TAXATION IN CASE OF NON-RESIDENTS

Section:- 44B, 44BB, 44BBA, 444BBB

Section No.	Nature of Business	Presumptive Rate of profit
44B	Shipping Business	Flat 7.5% of Receipts
44BB	Business of providing service of facilities in connection with supply of plant or machinery on hire for extraction of mineral oil. **[See Note given below]**	Flat 10% of Receipts
44BBA	Operation of aircraft	Flat 5% of Receipts
44BBB	Foreign companies engaged in civil construction business in connection with turnkey power projects – approved by central government. **[See Note given below]**	Flat 10% of Receipts

Note: Assessee may claim lower profits and gains than the aforesaid amount of 10% if the following two conditions are satisfied:

(a) The assessee keeps and maintains such books of account as are required u/s 44AA(2), and

(b) The assessee gets the accounts audited and furnishes a report of such audit as required u/s 44AB.

However, in the above cases, the Assessing Officer shall proceed to make assessment of the total income/ loss of the assessee only under scrutiny assessment as per section 143(3).

For detailed discussion of above sections and 44C, 44D and 44DA,

Refer Module IV- Chapter 54 -Taxation of Non-Resident

UNIT F – MISCELLANEOUS PROVISIONS

5.49 TAXABILITY OF SPECULATIVE TRANSACTIONS

Section:- 43(5) and Explanation to Section 73

(1) Meaning

Speculative transaction means a transaction involving a contract for purchase and sale of commodities, including stocks and shares, which is periodically or ultimately settled other than by actual delivery or transfer of commodities or scrips [Section 43(5)].

(2) Exceptions: [Proviso to Section 43(5)]

Following transactions are not regarded as speculative transactions

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him;

(b) 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;

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member;

(d) an eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 carried out in a recognised stock exchange;

(e) an eligible transaction in respect of trading in commodity derivatives carried out in a recognised association, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013

(3) Speculative business in the case of a company [Explanation to sec. 73]

Where any part (or whole) of the business of a company consists in the purchase and sale of shares of other companies, such company shall be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

The above Explanation to section 73 does not apply to the following companies:

(1) companies whose gross total income consists mainly of income which is chargeable under the heads 'Income from house property', 'Capital gains' and 'Income from other sources' ;

(2) companies whose principle business is the business of banking ;

(3) companies whose principle business is the business of trading in share; {Amendment by FA 2014}

(4) companies whose principle business is the business of granting loans and advances .

Practical 53

Surana Trading Pvt. Ltd. provides following information:

Sr. No.	Particulars	Rs.
(i)	Surplus from trading in goods (Delivery based)	4,80,000
(ii)	Surplus from speculative business	3,22,000
(iii)	Loss from trading in commodity derivatives	1,22,000
(iv)	Loss from business of buying and selling shares of other companies. (Delivery based trading)	2,22,000
(v)	Surplus from trading in stock derivatives	22,000

Find out business income of the company under following alternatives:

(i) Trading in shares is not the principle business of a company.

(ii) Trading in shares is the principle business of a company

Solution

Alternative 1 : Trading in shares is not the principle business of a company

Computation of Income under the head 'PGBP'

Particulars	Rs.	Rs.
Non-Speculative Income		
Surplus from Trading in goods (Delivery based)	4,80,000	
Loss from trading in commodity derivatives	(1,22,000)	
Surplus from trading in stock derivatives	22,000	3,80,000
Speculative Income		
Surplus from speculative business	3,22,000	
Loss from business of buying and selling shares of other companies. (Delivery based trading) **[NOTE]**	(2,22,000)	1,00,000
Income under the head "PGBP"		**4,80,000**

Note:

As discussed above, where any part (or whole) of the business of a company consists in the purchase and sale of shares of other companies, then such company shall be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares, even though it is delivery based trading. Therefore, Loss from business of buying and selling shares of other companies is treated as speculative loss.

Alternative 2:- Trading in shares is the principle business of a company.

Computation of Income under the head 'PGBP'

Particulars	Rs.	Rs.
Non-Speculative Income		
Surplus from non-speculative business	4,80,000	
Loss from trading in commodity derivatives	(1,22,000)	
Loss from business of buying and selling shares of other companies. (Delivery based trading) **[NOTE]**	(2,22,000)	
Surplus from trading in stock derivatives	22,000	1,58,000
Speculative Income		
Surplus from speculative business		3,22,000
Income under the head "PGBP"		**4,80,000**

Note: As per amendment made by Finance Act, 2014, deeming provisions of explanation to section 73 shall not be applicable to a company whose principle business is the business of trading in share. Therefore, Loss from business of buying and selling shares of other companies is treated as non-speculative loss.

Reader's Note:

5.50 TAX TREATMENT OF VRS PAYMENTS

Section:- 10(10C), 35DDA and Rule 2BA

(1) Tax treatment in the hands of employees [Section 10 (10C)]

Any amount received or receivable in accordance with any scheme of voluntary retirement by an employee of—

(i) a public sector company ; or

(ii) any other company ; or

(iii) an authority established under a Central, State or Provincial Act ; or

(iv) a local authority ; or

(v) a co-operative society ; or

(vi) a University established or incorporated by or under a Central, State or Provincial Act and an institution declared to be a University under section 3 of the University Grants Commission Act, 1956 ; or

(vii) an Indian Institute of Technology within the meaning of clause (g) of section 3of the Institutes of Technology Act, 1961; or

(viia) any State Government; or

(viib) the Central Government; or

(viic) an institution, having importance throughout India or in any State or States, as the Central Government may, by notification in the Official Gazette, specify in this behalf; or

(viii) such institute of management as the Central Government may, by notification in the Official Gazette, specify in this behalf,

is exempt from tax to the extent such amount does not exceed five lakh rupees :

Provided that the **schemes** of the said companies or authorities [or societies or Universities or the Institutes referred to in sub-clauses (*vii*) and (*viii*)], as the case may be, governing the payment of such amount **are framed in accordance with such guidelines as may be prescribed(Refer guidelines given below)**

Provided further that where exemption has been allowed to an employee under this clause for any assessment year, no exemption there under shall be allowed to him in relation to any other assessment year.

Provided also that where any relief has been allowed to an assessee under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under this clause shall be allowed to him in relation to such, or any other, assessment year.

(2) Guidelines [Rule 2BA]

(i) it applies to an employee who has completed 10 years of service or completed 40 years of age (this restriction is not applicable to an employee of public sector company);

(ii) it applies to all employees (by whatever name called) including workers and executives of a company or of an authority or of a co-operative society, as the case may be, excepting directors of a company or of a co-operative society;

(iii) the scheme of voluntary retirement has been drawn to result in overall reduction in the existing strength of the employees;

(iv) the vacancy caused by the voluntary retirement is not to be filled up;

(v) the retiring employee of a company shall not be employed in another company or concern belonging to the same management;

(vi) the amount receivable on account of voluntary retirement of the employee does not exceed the amount equivalent to three months salary for each completed year of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation :

Explanation: In this rule, the expression "salary" includes dearness allowance, if the terms of employment so provide.

(3) Tax treatment in the hands of Employers [Section 35DDA]

(a) Every assessee who has incurred expenditure by way of payment of any sum to an employee in connection with voluntary retirement under any scheme of VRS is entitled to claim deduction under this section.

(b) The amount so paid shall be allowed as deduction under the head "Profits and Gains of Business or Profession" in 5 equal instalments starting from the previous year in which such payment is made.

(c) The deduction under this section is available even though scheme of VRS is not framed as per guidelines prescribed under sec. 10(10C).

(d) For the balance period deduction under this section shall continue to be claimed by the amalgamated company after amalgamation, resulting company after demerger, Successor Company meeting conditions of sec. 47(xiii) and 47(xiv) after conversion of firm into company.

5.51 INCOME FROM UNDISCLOSED SOURCES

Section:- 68, 69, 69A, 69B, 69C and 69D

(1) Cash credit [Section 68]

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

Proviso to section 68

Further, any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or such amount, by whatever name called, in the accounts of such company shall be deemed to be not satisfactory unless-

the person, being a resident, in whose name such credit is recorded in the books of such company also explains, to the satisfaction of the Assessing Officer, the source of sum so credited as share application money, share capital, etc. in his hands.

However, this proviso shall not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) registered with SEBI.

Practical 54

Jantar Mantar Private Ltd. has credited a sum of Rs. 50 lakh in its books in July 2016 as share application money received from its resident shareholders Mr. Bhura and Mr. Uka. These shareholders claimed that they had made such investment out of their agriculture income. The Assessing Officer found that they are poor farmers and even does not own agricultural land. Discuss the tax treatment of such sum in the hands of Jantar Mantar Private Ltd.

What would be your answer if the books of account of the company showed further amount of Rs. 40 lakh towards share capital received from a Venture Capital Company registered with SEBI?

Solution

In this case, the amount of Rs. 50 lakh credited in the books of Jantar Mantar Private Ltd. as share application money received from the shareholders Mr. Bhra and Mr. Uka shall be treated as income of the company, since the shareholders were not able to explain to the satisfaction of the Assessing Officer, the source of such sum in their hands.

The said sum of Rs. 50 lakh shall be chargeable to tax@60% under section 115BBE and no allowance or expenditure or set off of loss shall be allowed to the company under any provision of the Income-tax Act, 1961 against such deemed income.

However, the proviso to section 68 would not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) registered with SEBI. Therefore, Rs. 40 lakh credited in the books of the company as share capital received from a Venture Capital Company registered with SEBI shall not be treated as income in the hands of the company.

Reader's Note:

(2) Unexplained investments [Section 69]

Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee for such financial year.

(3) Unexplained money, etc. [Section 69A]

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no

explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.

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

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.

(5) Unexplained expenditure, etc. [Section 69C]

Where in any financial year, an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year.

The proviso to section 69C provides that notwithstanding anything contained in any other provision of the Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income.

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

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

In order to avoid double taxation, it has been provided that if any amount borrowed on a hundi has been deemed under the provisions of the section to be the income of any person, such person should not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount.

Moreover, for the purpose of this section, the amount repaid includes the amount of interest paid on the amount borrowed.

(7) Section 115BBE

Income referred to in section 68 and 69 to 69D shall be taxed at flat rate of @ 60% percent (+SC +EC +SHEC). The tax shall be increased by surcharge @ 25%.

Further, no deduction in respect of any expenditure or allowance or set off of any loss shall be allowed to the assessee under any provision of this Act in computing his income referred to in above sections.

5.52 DEDUCTION IN RESPECT OF EXPENDITURE ON PRODUCTION OF FEATURE FILMS. (I.E. IN THE HANDS OF FILM PRODUCER) : RULE 9A

Rule :- 9A

Where a feature film is certified for release by the Board of Film Censors in any previous year and in such previous year,

(1) Situation (a)

The film producer sells all rights of exhibition of the film, the entire cost of production of the film shall be allowed as a deduction in computing the profits and gains of such previous year.

(2) Situation (b)

Where the film producer

(i) himself exhibits the film on a commercial basis in all or some of the areas; or

(ii) sells the rights of exhibition of the film in respect of some of the areas; or

(iii) himself exhibits the film on a commercial basis in certain areas and sells the rights of exhibition of the film in respect of all or some of the remaining areas,

and the film is released for exhibition on a commercial basis at least ninety days before the end of such previous year, the entire cost of production of the film shall be allowed as a deduction in computing the profits and gains of such previous year.

However, if film is not released for exhibition on a commercial basis at least ninety days before the end of such previous yea, the cost of production of the film shall be allowed as deduction to the extent of amount realized from such release and the balance, if any, shall be carried forward to the next following previous year and allowed as a deduction in that year.

(3) Situation (c)

Where the film producer does not himself exhibit the film on a commercial basis or does not sell the rights of exhibition of the film, no deduction shall be allowed in respect of the cost of production of the film in computing the profits and gains of such previous year; and the entire cost of production of the film shall be carried forward to the next following previous year and allowed as a deduction in that year.

(4) Situation (d)

Where the Assessing Officer is of opinion that

(a) the rights of exhibition of the feature film have been transferred by the film producer by a mode not covered by the provisions of this rule; or

(b) having regard to the facts and circumstances of any case, it is not practicable to apply the provisions of this rule to such case,

deduction in respect of the cost of production of the film may be allowed by the Assessing Officer in such other manner as he may deem suitable.

(5) Meaning of Cost of production

Cost of production, in relation to a feature film, means the expenditure incurred on the production of the film, but does not include

(a) the expenditure incurred for the preparation of the positive prints of the film; and

(b) the expenditure incurred in connection with the advertisement of the film after it is certified for release by the Board of Film Censors.

Further, the cost of production of a feature film, shall be reduced by the subsidy received by the film producer under any scheme framed by the Government, where subsidy has not been included in computing the total income of the assessee for any assessment year.

Practical 55

Mr. Mahesh is a film producer. He provides following information about the various films produced by him and certified by the Board of film censors.

Name of Film	Whether all rights sold?	Date of release	Collection (Rs. in crore)	Cost of production (Rs. in crore)
Film A	Yes	14-02-2018	5	12
Film B	No	10-08-2017	13	8
Film C	No	02-01-2018	16	21

Film D was released last year **on 10-01-2017** where the collection during previous year **2016-17** was Rs. 4 crore as against the cost of production amounting to Rs. 12 Cr. This film fetched further collection of Rs. 14 crore in the previous year **2017-18**. However, the return for the previous year **2016-17** was not filed within the time allowed under section 139(1).

Further, Film E was certified for release by Board during the previous year but it was abandoned by producer. The cost of production of this film was Rs. 7 Cr.

Find out income of Mr. Mahesh under the head "PGBP" for the previous year **2017-18**.

Solution

Name of Film	Collection (Rs. in crore)	Cost of production (Rs. in crore)	Surplus (Deficit)	Remark
Film A	5	12	(7)	Since all rights sold out, entire cost is allowed as deduction.
Film B	13	8	5	Since Film got released at least 90 days before the end of previous year, entire cost is allowed as deduction.
Film C	16	16	Nil	Since film got released in last 90 days of the previous year, deduction of cost shall be restricted to the amount of collection. Balance cost of Rs. 5

				Cr. shall be carried forward and allowed as deduction in the previous year **2018-19**
Film D	14	8 (unabsorbed deduction of last year)	6	The late filing of return will hamper the right to carry forward the loss and not to the amount of unamortized cost of production under rule 9A.- CIT vs. Joseph Valakuzhy **302 ITR 190 (SC).**
Film E	Nil	7	(7)	Expenditure incurred on abandoned film is to be treated as revenue expenditure and allowed as deduction under section 37(1) of the Act- **Circular No. 16/2015**
Income under head PGBP			**(3)**	Business loss to be carried forward provided return for the previous year **2017-18** has been filed on or before due date under section 139(1)

Reader's Note:

5.53 DEDUCTION IN RESPECT OF EXPENDITURE ON ACQUISITION OF DISTRIBUTION RIGHTS OF FEATURE FILM (I.E. IN THE HANDS OF FILM DISTRIBUTOR)

Rule :- 9B

Where a feature film is acquired by the film distributor in any previous year and in such previous year,

(1) Situation (a)

The film distributor sells all rights of exhibition of the film, the entire cost of acquisition of the film shall be allowed as a deduction in computing the profits and gains of such previous year.

(2) Situation (b)

Where the film distributor

(i) himself exhibits the film on a commercial basis in all or some of the areas; or

(ii) sells the rights of exhibition of the film in respect of some of the areas; or

(iii) himself exhibits the film on a commercial basis in certain areas and sells the rights of exhibition of the film in respect of all or some of the remaining areas,

and the film is released for exhibition on a commercial basis at least ninety days before the end of such previous year, the entire cost of production of the film shall be allowed as a deduction in computing the profits and gains of such previous year.

However, if film is not released for exhibition on a commercial basis at least ninety days before the end of such previous yea, the cost of production of the film shall be allowed as deduction to the extent of amount realized from such release and the balance, if any, shall be carried forward to the next following previous year and allowed as a deduction in that year.

(3) Situation (c)

Where the film distributor does not himself exhibit the film on a commercial basis or does not sell the rights of exhibition of the film, no deduction shall be allowed in respect of the cost of production of the film in computing the profits and gains of such previous year; and the entire cost of production of the film shall be carried forward to the next following previous year and allowed as a deduction in that year.

(4) Meaning of Cost of acquisition

Cost of acquisition, in relation to a feature film, means the amount paid by the film distributor to the film producer or to another distributor under an agreement for acquiring the rights of exhibition and, where the rights of exhibition have been acquired on a minimum guarantee basis, the minimum amount guaranteed, but does not include—

(i) the amount of expenditure incurred by the film distributor for the preparation of the positive prints of the film; and

(ii) the expenditure incurred by him in connection with the advertisement of the film.

Practical 56

Meghna Film Distributors have acquired the rights of exhibition of a feature film 'Nasha' in the territory of Rajasthan from the producers under an agreement executed on **11.06.17** against a consideration of Rs. 300 lacs. It thereafter executed a sub-agreement with a distributor to whom the rights of exhibition of the film in some of the areas of Rajasthan were assigned against an amount of Rs. 100 lacs. The film was released for exhibition on commercial basis on **25.12.17**. Collection from the exhibition of film of "Meghna Film Distributors" for **25.12.2017 to 10.01.2018** was Rs. 50 lacs and thereafter up to **31.03.2018** was Rs. 190 lacs.

It asks you to clarify as to how these transactions will be reflected in the Income-tax return for **A.Y. 2018-19.** Would your answer be different if the film was released for exhibition on **11.01.2018**?

Solution

Meghna Film Distributors is engaged in the business of exhibition of feature films after taking the rights from the producers. The profits and gains of such business are to be computed as per the provisions given in Rule 9B of the Income-tax Rules, 1962.

In the present problem, the agreement was executed on **11.06.2017** and the film also stands released for exhibition on commercial basis before 90 days from the end of the financial year i.e., on **25.12.17**. Accordingly, the profit of the assessee will be computed as under: -

Particulars	Rs. In lakhs
Collection from exhibition of film (Rs. 50 lakhs + Rs.190 lakhs)	240
Collection from sub-distributor	100
	340
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film	(300)
Net income of film "Nasha"	40

Release of film for exhibition on commercial basis in the second case on **11.01.2018** i.e., less than 90 days before the end of the previous year. In this case, the profits of the assessee will be as under :-

Particulars	Rs. In lakhs
Collection from exhibition of film (Refer Note)	190
Collection from sub-distributor	100
	290
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film (` 300 lacs, but restricted to Rs. 290 lacs)	(290)
Net income of film "Nasha"	Nil

The balance of Rs. 10 lacs (i.e. Rs. 300 lacs – Rs.290 las) has to be carried forward to the next following previous year and allowed as a deduction in that year i.e., **F.Y.2018-19.**

Note- Collection from exhibition of film from **25.12.2017 to 10.01.2018** amounting to Rs. 50 lacs is not considered in case of release of film on **11.01.2018** as it relates to a period before the date of release, so, it is relevant only in the first case when the film was released on **25.12.2018**.

Reader's Note:

5.54 INVESTMENT IN NEW PLANT OR MACHINERY IN NOTIFIED BACKWARD AREAS IN CERTAIN STATES.

Section:- 32AD

(1) Amount of deduction under section 32AD

= 15% of Actual Cost subject to following conditions

(2) Conditions

(1) The assessee is a company or any other person.

(2) Assessee sets up an undertaking or enterprise for manufacture or production of any article or thing on or after 01.04.2015.

(3) Such undertaking or enterprise must be set in any backward area notified by the Central Government in this behalf, in the State of Andhra Pradesh, Bihar, Telangana or West Bengal.

(4) Assesse acquires and installs a 'new asset' for the purposes of the said undertaking.

(5) The new asset should be acquired and installed after March 31, 2015 but before April 1, 2020.

(3) Other Points

(1) Meaning of "New Asset" used in above provision:-

"New asset" means any new plant or machinery (other than ship or aircraft) 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; or

(v) 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.

(2) Withdrawal of investment allowance if new asset is subsequently sold or otherwise transferred–

- The new asset shall not be sold or otherwise transferred within a period of 5 years from the date of its installation.
- If the new asset is sold or otherwise transferred within 5 years from its installation, then the amount of deduction claimed under section 32AD shall be deemed to be the income of assessee of the previous year in which such asset is sold or otherwise transferred.
- Such deemed income will be taxable under the head "Profit and gains of business or profession".
- Such deemed income shall be in addition to taxability of capital gain, if any.

(3) Above restriction shall not apply in case of amalgamation or demerger or conversion of proprietorship / partnership firm into company or conversion of unlisted company into LLP

- The above restriction shall not apply in a case of amalgamation or demerger or conversion of proprietorship / partnership firm into company or conversion of unlisted company into LLP.
- However, the amalgamated company or the resulting company or the successor company or LLP shall not transfer the new asset within 5 years from its installation by the amalgamating company or demerged company or predecessor.
- If it is sold or otherwise transferred within 5 years by the amalgamated company or resulting company, then the amount of deduction claimed under section 32AD shall be deemed to be the income of amalgamated company or resulting company or the successor company or LLP, as the case may be.

- Such deemed income will be taxable under the head "Profit and gains of business or profession".
- Such deemed income shall be in addition to taxability of capital gain, if any.

Practical 57

RAJAD Limited set up a manufacturing unit in notified backward area in the State of Bihar on **01.07.2017**. It provides following information:

(i) Purchased new plant and machinery Rs. 40 crores on **01.07.2017** and put to use on **01.08.2017**.

(ii) Purchased second hand plant and machinery Rs. 10 crores on **01.09.2017** and put to use on the same day.

(iii) Further purchased new plant and machinery Rs. 20 crores on **01.11.2017** but put to use on **10.12.2017**.

You are required to compute the various tax advantages for RAJAD Limited. Also find out written down value of block plant and machinery as on 01-04-2018.

Solution

Computation of Depreciation and Additional Depreciation for previous year 2017-18

Particulars	Actual Cost of Asset	Whether Put to use for < 180 days?	Rate of Depreciation	Amount of Depreciation	Rate for Additional Depreciation	Amount of Additional Depreciation
New Plant & Machinery put to use on **01.08.2017**	40 Cr.	No	15%	6.00 Cr.	35%	14.00 Cr.
Second hand Plant & Machinery put to use on **01.09.2017**	10 Cr.	No	15%	1.50 Cr.	Not Eligible because Second Hand	Nil
New Plant & Machinery put to use on **10.12.2017**	20 Cr.	Yes	7.5%	1.50 Cr.	17.5%	3.50 Cr.
Total				**9.00 Cr.**		**17.50 Cr.**

Computation of Investment allowance under section 32AD for the previous year 2017-18

Particulars	Actual cost of Asset	Deduction under section 32AD: 15% of Actual Cost
New Plant & Machinery put to use on **01.08.2017**	40 Cr.	6 Cr
Second hand Plant & Machinery put to use on **01.09.2017**	Not Eligible because Second Hand	Nil
New Plant & Machinery put to use on **10.12.2017**	20 Cr.	3 Cr.
Total		**9 Cr.**

Calculation of Written Down Value as on 1st April, 2018.

Particulars	Rs. In crores
Opening W.D.V as on 1st April 2017	Nil
Add: Purchase of New Plant & Machinery during the previous year 2017-18	60.00
Add: Second hand Plant & Machinery during the previous year 2017-18	10.00
W.D.V. for the previous year 2017-18	70.00
Less : Normal Depreciation [as per earlier calculation]	(9.00)
Less : Additional Depreciation [as per earlier calculation]	(17.50)
W.D.V as on 1st April 2018	**43.50**

Notes:

1. Additional depreciation is not available on second hand plant and machinery.
2. Investment allowance under section 32AD is in addition to depreciation (including additional depreciation)
3. To arrive at written down value as on 1st April, 2018, only depreciation (including additional depreciation) actually allowed under section 32 shall be reduced. Therefore, investment allowance, not being depreciation under section 32, shall not be reduced to arrive at written down value of plant and machinery block.

Reader's Note:

5.55 SPECIAL PROVISION FOR COMPUTING DEDUCTIONS IN THE CASE OF BUSINESS REORGANIZATION OF CO-OPERATIVE BANKS

Section:- 44DB

Refer Module III Chapter No. 40

5.56 CRITICAL JUDICIAL RULINGS IN QUESTION – ANSWER FORMAT

(1) Section 2(13):- Definition of term "Business"

Case Study 6

What is an adventure in the nature of trade? State the factors which are relevant in deciding whether a transaction is an adventure in the nature of trade.

Solution

The term "business" has been defined in section 2(13) of the Income-tax Act, 1961 to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Adventure in the nature of trade implies that the adventure has the characteristics of trade but not all of them. That indeed is the distinguishing mark of an adventure since if it possessed all the characteristics it would be a full blown trade straightaway.

The **Supreme Court has, in G. Venkataswami Naidu & Co. v. CIT (1959) 35 ITR 594 and CIT v. H. Holck Larsen (1986) 160 ITR 67,** identified certain factors which are relevant in deciding whether a transaction is an adventure in the nature of trade.

In deciding whether a transaction is an adventure in the nature of trade, several factors are relevant such as

- the motive, intention or purpose with which the article sold was bought earlier,
- the character of articles purchased and sold, that is, whether the articles are fit for sale as merchandise,
- ordinary occupation of the assessee, that is, whether he is a trader or not, whether the purchase of the commodity and its resale were allied to his usual trade or incidental to it,
- quantity of the commodity purchased and sold,
- acts prior to purchase showing a design or purpose,
- manner of disposal,
- similarity of transactions to operations usually associated with trade or business, repetition of transactions,
- period of holding,
- circumstances that led to the sale,
- treatment in books of account etc.

In each case, it is the total effect of all relevant factors and circumstances that determine the character of the transaction.

Reader's Note:

(2) Section 28 :- Chargeability

Case Study 7

Examine the taxability or allowability or otherwise in the following cases while computing income under the head "Profits and gains from business or profession" to be declared in the return of income for the assessment year 2017-18:

(i) Donations received by a person in the course of carrying on vocation, from his followers.

(ii) Profit derived by an assessee engaged in carrying on the business as dealer in shares, on exchange of the shares held as stock in trade of one company with the shares of another company.

(iii) The amount of margin money forfeited by a bank on the failure of its constituents of not taking the delivery of the shares purchased by such bank on their behalf.

Solution

Taxability of the following receipts/income while computing income under the head "Profits and gains of business or profession"

(i) Donations received by a person from his followers in the course of carrying on vocation for the furtherance of the objects of his vocation are receipts arising from carrying on of his vocation and are not casual or non-recurring receipts. The Supreme Court, in **Dr. K. George Thomas vs. CIT (1985) 156 ITR 412,** has held that such donations are taxable as business income as there is

a direct nexus between the vocation carried on by the assessee and the receipt of such donations.

(ii) The difference between the price of shares of the first company and the market value of shares of the new company on the date of such exchange is to be treated as "profit" derived by the dealer in shares (on exchange of shares held as stock-in-trade of the first company with the shares of the new company) in the normal course of business, and hence such profit is taxable as business income. It was so held by the **Supreme Court in Orient Trading Co. Ltd. vs. CIT (1997) 224 ITR 371.**

(iii) Since the bank is purchasing shares on behalf of the constituents, the forfeiture of margin money by the bank from the constituents for not paying the balance amount of purchase price and not taking delivery of shares purchased by the bank on their behalf is in the normal course of its banking business and hence, the forfeited amount is assessable as business income of the bank. The forfeited amount being revenue in nature cannot be adjusted against the purchase price of the shares. **The Supreme Court has, in the case of CIT vs. Lakshmi Vilas Bank Ltd. (1996) 220 ITR 305**, confirmed this view.

Reader's Note:

Case Study 8

The assessee, K and Co. running a lottery, deposited certain funds with a bank in order to obtain bank guarantee to be furnished to the State Government of Sikkim. Such guarantee enabled the assessee to carry on the business of printing lottery tickets and for conducting lotteries on behalf of the State Government of Sikkim. The funds which were held as margin money, earned some interest.

Is interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable as business income?

Solution

In case of **CIT v. K and Co. (2014) 364 ITR 93 (Del), the High Court** noted that the interest income from the deposits made by the assessee is inextricably linked to the business of the assessee and such income, therefore, cannot be treated as income under the head 'Income from other sources'. The margin money requirement was an essential element for obtaining the bank guarantee which was necessary for the contract between the State Government of Sikkim and the assessee. If the assessee had not furnished bank guarantee, it would not have got the contract for running the said lottery.

The High Court, accordingly, held that the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".

Reader's Note:

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(3) Section 31:- Repairs and Insurance of Machinery, Plant and Furniture

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Case Study 9

Mr. S, a lawyer by profession, incurred expenditure on his heart surgery. He claimed such expenditure arguing that the repair of vital organ i.e. the heart, has directly impacted his professional competence

as his gross income from profession increased manifold after the surgery, the heart should be treated as a plant and hence such expenses should be allowed under section 31 as current repairs to plant and machinery or section 37(1) as an expenditure incurred wholly and exclusively for the purpose of his profession. Is the claim of Mr. S tenable in law?

Solution

These issues came up before the **Delhi High Court in the case of Shanti Bhushan v. CIT (2011) 336 ITR 26,** wherein it was observed that to allow the heart surgery expenditure as repair expenses to plant, the heart should have been first included in the assessee's balance sheet as an asset in the previous year and in the earlier years. Also, a value needs to be assigned for the same. The assessee would face difficulty in arriving at the cost of acquisition of such an asset for showing the same in his books of account. Though the definition of plant is inclusive in nature but the plant must have been used as a business tool which is not true in the case of 'heart'. Therefore, the heart cannot be said to be a plant for the business or profession of the assessee. Therefore, the expenditure on heart surgery is not allowable as repairs to plant under section 31.

According to the provisions of section 37(1), inter alia, the said expenditure must be incurred wholly and exclusively for the purposes of the assessee's profession. As mentioned above, a healthy heart will increase the efficiency of human being in every field including its professional work. Therefore, there is no direct nexus between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37(1) is also not tenable.

Applying the rationale of the above court ruling to the case on hand, the claim of Mr. S is not tenable in law.

Reader's Note:

Case Study 10

Repairs of plant and machinery debited to profit and loss account includes Rs. 1.80 lacs towards replacement of worn out parts of machineries. Such expenditure does not increase the future benefit from the asset beyond its previously assessed standard of performance.

Solution

Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction.

The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery **[CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].**

Here expenditure on repairs does not bring in any new asset into existence.

Such replacement can only be considered as current repairs. Hence, no adjustment is required.

Reader's Note:

(4) Section 36(1)(ii):- Bonus

Case Study 11

Capsule Ltd, during the financial year ended 31.3.2017 paid production bonus of an amount of Rs. 30 lacs pursuant to a settlement arrived with the workers in addition to the statutory payment of Rs. 10 lacs as per the Payment of Bonus Act, 1965. Your advise is sought on the following:

(a) Whether the sum of Rs. 40 lacs is deductible as per the provisions of section 36(1)(ii)?

(b) If the claim is not deductible, can it be claimed under any other provision?

Solution

Under section 36(1)(ii), deduction is allowed in respect of any sum paid to an employee as bonus or commission for services rendered where such sums would not have been payable to him as profits or dividend, if it had not been paid as bonus or commission. Rs. 10 lacs being paid as bonus as per the Payment of Bonus Act, 1965 is deductible as per the provisions of section 36(1)(ii).

Further, as per the **Madras High Court ruling in CIT v. Kasturi Mills Ltd. (1998) 234 ITR 538**, the remaining Rs.30 lacs can be claimed as deduction under section 37(1) on the grounds of commercial expediency since the expenditure is laid out wholly and exclusively for business purposes.

Since the bonus amount was paid during the financial year 2017-18, it is not hit by the provisions of section 43B.

Reader's Note:

(5) Section 36(1)(iii):- Interest on Borrowed Capital

Case Study 12

X. Ltd. issued debentures in the previous year 2017-18, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of Rs. 60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2017-18.

Examine the correctness of the action of Assessing Officer.

Solution

The facts of the case are similar to the facts in **Taparia Tools Ltd. v. JCIT (2015) 372 ITR 605,** wherein the above issue came up before the Supreme Court.

In that case, it was observed that under section 36(1)(iii), the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

The moment the option for upfront payment was exercised by the subscriber, the liability of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

Following the rationale of the Supreme Court ruling in Taparia Tools Ltd.'s case, when the deduction of entire upfront payment of interest is allowable as per the Income-tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2017-18 to one-fifth of the upfront interest paid is contrary to the law declared by Supreme Court.

Reader's Note:

(6) Section 36(1)(vii):- Bad- Debts

Case Study 13

PQR Limited has written off certain debts as bad debts in the books of account and claimed deduction under section 36(1)(vii) in the return of income filed for A.Y. 2017-18. The Assessing Officer made disallowance for deduction of bad debts on the ground that the debts have not been established to have become irrecoverable and bad in the previous year 2016-17.

Examine the correctness of the action of the Assessing Officer.

Solution

As per section 36(1)(vii), the amount of any bad debts or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction in that year, subject to the provisions of section 36(2). Section 36(2), inter alia, provides that such debt should have been taken into account in computing the income of the assessee for the previous year in which it was written off or any earlier previous year or represents money lent in the ordinary course of business of banking or money-lending which is carried on by the assessee.

Therefore, there is no requirement under section 36(1)(vii) to establish that the debt has become irrecoverable or bad. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee during the relevant previous year. It was so held by the **Apex Court in the case of T.R.F. Ltd. v. CIT (2010) 323 ITR 397.**

Reader's Note:

Case Study 14

P. Limited has two divisions, engineering division and tea division. It has transferred engineering division to Q. Limited pursuant to a scheme of demerger which satisfies the conditions of section 2(19AA). P. Limited had a debt of Rs. 5 lakhs in engineering division which stood transferred to Q. Limited. The said debt has been written off as bad in the accounts of Q. Ltd. Can Q. Limited claim deduction on account of the bad debt?

Solution

The SC in case of **CIT V. T.Veerabhadra Rao[1985]22Taxman45** made following observation:

The benefit of deduction of bad debts which have been written off under section 36(2)(i) is not accorded to the assessee by way of personal relief but relates to business. Therefore, deduction is not only available to the assessee, but it is also available to the succeeding assessee inasmuch as "the assessee" referred to in section 36(2)(i) need not be the "same assessee".

Considering the ratio of the above judgement that benefit of deduction in relation to bad debt is available to the successor assessee, Q Ltd. can claim deduction of bad debt amounting to Rs. 5 Lac.

Reader's Note:

(7) Section 36(1)(va):- Employee's Contribution to Provident Fund

Case Study 15

Gujarat State Road Transport Corpn collected employees' contribution to Provident Fund and ESI which were remitted, after the due date under the relevant Acts but before the 'due date' for filing the return specified in section 139(1). The assessing officer observed that the amount collected by way of employees' contribution to PF and ESI are income under section 2(24)(x) and their remittance is governed by section 36(1)(va). The time limit prescribed for remitting the contribution is the 'due date' prescribed under the Provident Funds Act, Employees' State Insurance Act, rule, order or notification issued thereunder or under any standing order, award, contract or service or otherwise. Therefore, the assessing officer not allowed the deduction in respect of employees' contribution remitted after the due date under the relevant act. Whether action of assessing officer is justified?

Solution

In case of **CIT v. Gujarat State Road Transport Corpn (2014) 366 ITR 170, Gujarat High Court** observed that section 43B(b) pertaining to employer's contribution cannot be applied with respect to employees' contribution which is governed by section 36(1)(va).

So far as the employee's contribution is concerned, the Explanation to section 36(1)(va) continues to remain in the statute and there is no provision for applying the extended time limit provided under section 43B for remittance of employee's contribution. The amount of employee's contribution to PF and ESI is an income upon recovery from salary and its remittance within the 'due date' as specified in Explanation to section 36(1)(va) makes it eligible for deduction.

Employees' contribution recovered by the employer is not eligible for extended time limit upto the due date of filing of return, which is available under section 43B in the case of employer's own contribution. The High Court, accordingly, held that the remittance of employees' contribution beyond the 'due date' prescribed in section 36(1)(va), is not deductible while computing the business income, even though such remittance has been made before the due date of filing of return of income under section 139(1).

Remarks:

(a) A contrary view was expressed by Uttrakhand High Court in the case of CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 351.

(b) CBDT in its Circular No. 22/ 2015 dated 17-12-2015 clarified that if the assessee deposits any sum payable as an employer by way of contribution to any provident fund or superannuation fund or any other fund for the welfare of employees on or before due date of furnishing return, no disallowance can be made under section 43 B.

It has further clarified that this circular does not apply to the claim relating to employees' contribution which are governed by section 36(1)(va) of the Income Tax Act, 1961.

Reader's Note:

(8) Section 40(a)(ia) :- Disallowance

Case Study 16

There have been conflicting interpretations by judicial authorities regarding disallowance under section 40(a)(ia). In that one of the view in favour of assessee was that disallowance under section 40(a)(ia) would be invoked only in respect of the amount which remained payable at the end of relevant financial year and not in respect of the amount which had actually been paid during the previous year without deduction of tax at source. This conflict has been done away by Supreme Court. You are required to mention that in whose favour conflict has been resolved and what are the reasons awarded by Supreme Court for bringing down the conflict.

Solution

Supreme Court in case of Palam Gas Service vs. CIT dated 4th May, 2017 held that Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. In this behalf, one has to keep in mind the purpose with which Section 40 was enacted and that has already been noted above. We have also to keep in mind the provisions of Sections 194C and 200. Once it is found that the aforesaid Sections mandate a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself. Certain consequences of failure to deduct tax at source from the payments made, where tax was to be deducted at source or failure to pay the same to the credit of the Central Government, are stipulated in Section 201 of the Act. This Section provides that in that contingency, such a person would be deemed to be an assessee in default in respect of such tax. While stipulating this consequence, Section 201 categorically states that the aforesaid Sections would be without prejudice to any other consequences which that defaulter may incur. Other consequences are provided under Section 40(a)(ia) of the Act, namely, payments made by such a person to a contractor shall not be treated as deductible expenditure. When read in this context, it is clear that Section 40(a)(ia) deals with the nature of default and the consequences thereof. Default is relatable to Chapter XVIIB (in the instant case Sections 194C and 200, which provisions are in the aforesaid Chapter). When the entire scheme of obligation to deduct the tax at source and paying it over to the Central Government is read holistically, it cannot be held that the word 'payable' occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. If the provision is interpreted in the manner suggested by the appellant herein, then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIB (or specifically Sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such monetary default in spite of specific provisions laying down these consequences.

Reader's Note:

(9) Section 41(1):- Deemed Income

Case Study 17

"Shanaz Ltd" engaged in manufacturing of different products was asked by the Central Excise Department to pay an amount of Rs. 25,00,000 on certain goods manufactured by it, which was deposited during the financial year 2012-13 and was claimed as deduction in the return of income filed for that assessment year. This levy of the excise duty was challenged in the High Court, and the Court in June, 2016 held "that the same is not payable by the company". The Excise Department filed appeal challenging the order of the High Court before the Supreme Court. In the meantime, assessee company received refund of excise duty. The Assessing Officer, therefore, issued a show cause to tax the refund received by the company in A.Y. 2017-18. Assessee company, however, argued that the matter is pending before Supreme Court and therefore, there is no remission or cessation of liability as envisaged under section 41(1) of the Act. Discuss the validity of contention raised by the assessee company.

Solution

The **Supreme Court, in Polyflex India (P) Ltd v CIT (2002) 257 ITR 343,** has held that where a statutory levy in respect of goods dealt with by the assessee is discharged and a deduction is allowed thereon, and subsequently, the amount paid is refunded, the first part of section 41(1)(a) would apply i.e. it will be a case where the assessee "has obtained any amount in respect of such expenditure". Where expenditure is actually incurred by reason of payment of duty on goods and a deduction or allowance is given in the assessment of an earlier period, the assessee is liable to tax on that benefit, as and when he obtains refund of the amount so paid. The possibility of the refund being set at naught on a future date will not be a relevant consideration.

Considering the rationale of above ruling, the contention raised by the assessee company is not valid and therefore, refund of excise duty is chargeable to tax under section 41(1) in the year of receipt. However, in future, Supreme Court upholds levy, then the assessee company is again eligible for deduction on actual payment.

Reader's Note:

(10) Section 40A(2):- Payment to relatives / related parties

Case Study 18

X & Co., a partnership firm consisting of three partners, enhanced working partner salary from Rs.25,000 per month for each partner to Rs.50,000 per month for each partner. The increase in working partner salary was authorised by the deed of partnership.

The Assessing Officer during the course of assessment contended that the remuneration paid to working partners at Rs. 50,000 per month for each partner as excessive and applied section 40A(2)(a) though the payment was within the statutory limit prescribed under section 40(b)(v). Decide the correctness of action of the Assessing Officer

Solution

The facts of the case are similar to the facts in **CIT v. Great City Manufacturing Co. (2013) 351 ITR 156,** wherein, the above issue came up before the Allahabad High Court.

The High Court observed that section 40(b)(v) prescribes the limit of remuneration to working partners, and deduction is allowable up to such limit while computing the business income. If the remuneration paid is within the ceiling limit provided under section 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken.

Hence, applying the rationale of the Allahabad High Court ruling in Great City Manufacturing Co.'s case, the increased remuneration which is authorized by the partnership deed and is within the limits specified under section 40(b)(v) and paid to working partners, cannot be disallowed by invoking the provisions of section 40A(2)(a). Therefore, the action of assessing officer is not correct.

Reader's Note:

(11) Section 43B:- Certain Deductions on actual payment

Case Study 19

Can the following transactions be covered under section 43B for disallowance?

(i) A bank guarantee given by a company towards disputed tax liabilities.

(ii) Interest payable to Sales Tax Department but not paid before the due date specified in section 139(1).

Solution

(i) For claiming deduction of any expense enumerated under section 43B, the requirement is, the actual payment. Furnishing of bank guarantee is just guaranteeing payment and it cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee **[CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)]**

(ii) Interest payable to Sales tax department is also a part of sales tax. Therefore, interest payable to sales tax department, which is not paid before the "due date" of filing of return of income, would attract disallowance under section 43B **[Mewar Motors v. CIT (2003) 260 ITR 218 (Raj)]**

Reader's Note:

Case Study 20

A Ltd. paid IDBI (a public financial institution) a lump sum pre-payment premium of Rs. 1.2 lacs on 7.4.2016 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2016-17. The Assessing Officer, however, held that the pre-payment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y.2016-17. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.

Solution

This issue came up before the **Delhi High Court in CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434**. The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that the pre-payment premium was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Reader's Note:

Case Study 21

Shasun Chemicals & Drugs Ltd. and its employees union had a dispute as regard the quantum of bonus which led to labour unrest. Due to this reason, the workers refused to accept the bonus offered to them. However, in order to comply with the requirement of section 43B, the assessee made payment to a trust. The dispute with the workers was settled well in time and the bonus was paid to the workers on the very next day of deposit of the said amount in the trust that too, before the 'due date' by which such payment is supposed to be made in order to claim deduction under section 36.

The Assessing Officer, however, took a view that since the payment was made from the trust and not made by the assessee directly to the employees, it is not allowable in view of the provisions of section 40A(9) of the Act. Whether the view taken by the assessing officer is correct?

Solution

Supreme Court in case of Shasun Chemicals & Drugs Ltd v. CIT (2016) 388 ITR 1 held that the amount paid by way of bonus is one of the expenditures which is allowable as deduction under section 36(1)(ii). It also held that the embargo contained in section 43B(b) or section 40A(9) does not come in the way of the assessee's claim, since the bonus was ultimately paid to the employees before the due date as per the statutory requirement. Therefore, the payment in respect of bonus is allowable as deduction, as there is no dispute that the amount was paid by the assessee to its employees before the due date by which such payment is supposed to be made in order to claim deduction under section 36(1)(ii).

In the light of judicial pronouncement discussed above, the view taken by the assessing officer in not allowing deduction of bonus is not correct.

Reader's Note:

5.57 CRITICAL JUDICIAL RULINGS – SECTION 37(1)

Conditions for allowability of expenditure:

(1) The expenditure should not be in the nature as prescribed u/s. 30 to 36.
(2) It should be incurred in connection with business or profession carried on by the assessee.
(3) It should have been expended wholly and exclusively for the purpose of such business or profession.
(4) The expenditure should not be in the nature of capital expenditure
(5) It should not be of personal expenditure
(6) It should be incurred during the previous year.

Explanation 1:- No deduction shall be allowed under this section in respect of an expenditure incurred for any purpose, which is an offence or is prohibited by law.

Explanation 2:- No deduction shall be allowed under this section in respect of an expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013.

(1) Expenditure should not be in the nature as prescribed u/s. 30 to 36.

Case Study 22

Shriram Pistons and Rings Ltd. v. CIT 307 ITR 363 (Del.)

Conclusion

The following question was raised before the High Court in a reference filed by the Revenue :

"Whether the Tribunal was right in holding that the payments made by the assessee to its employees under the nomenclature **'Good work reward'** did not constitute bonus within the meaning of S. 36(1)(ii) of the Income-tax Act, 1961 and were allowable as normal business expenditure u/s. 37 ?"

The Delhi High Court held as under :

(i) The word 'bonus' has not been defined anywhere including the Payment of Bonus Act, 1965. However, for the purpose of industrial law, four types of bonus have been recognised : (a) production bonus, (b) contractual bonus, (c) customary bonus usually associated with festivals, and (d) profit-sharing bonus.

(ii) The 'good work reward' that was given by the assessee to some employees on the recommendation of senior officers of the assessee did not fall in any of the categories of bonus specified under the industrial law. There was nothing to suggest that the good work reward given by the assessee to its employees had any relation to the profits that the assessee may or may not make.

(iii) The reward had relation to the good work done by the employee during the course of his employment and at the end of the financial year on recommendation of a senior officer of the assessee, the reward was given to the employee. Consequently, the 'good work reward' could not fall within the ambit of S. 36(1)(ii) of the Act.

(iv) The 'good work reward' was allowable as business expenditure u/s. 37(1) of the Act."

Reader's Note:

(2) Expenditure is incurred for the purpose of carrying on business

Case Study 23

Jayshree Tea and Industries Ltd. v. CIT [2005] (Cal.)

Conclusion

Compensation paid to workers **on closing one of units** be allowed to be deducted when there was unity of control and management of various units and all were assessed in assessee's hands as one business

Reader's Note:

Case Study 24

CIT v Margarined Refined Oils Co. Ltd. (2006) 154 Taxman 95 (Kar)

Conclusion

Where the assessee, who has engaged in business of manufacturing and trading, discontinued manufacturing and let out manufacturing unit but continued with trading unit, the retrenchment compensation paid to employees of manufacturing unit was allowable deduction.

Reader's Note:

(3) When to claim business liability as deduction u/s 37(1)?

Case Study 25

Bharat Earth Movers v CIT

Conclusion

When can a business liability be claimed as deduction

If a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of liability and capability of being estimated with reasonable certainty. Then such liability shall be allowed as deduction.

Reader's Note:

Case Study 26

Rotork Controls India P. Ltd. v. CIT (2009) 314 ITR 62 (SC)

Conclusion

The appellant-company sold valve actuators. The bulk of the sales was to BHEL. At the time of sale, the appellant (assessee) provided a standard warranty whereby in the event of any beacon rotork actuator or part thereof becoming defective within 12 months from the date of commencing or 18 months from the date of dispatch, whichever was earlier, the company undertook to rectify or replace the defective part free of charge. This warranty was given under certain conditions stipulated in the warranty clause. For the A.Y. 1991-92, the asessee made a provision for warranty at Rs.10,18,800 at the rate of 1.5% of the turnover. This provision was made by the assessee on account of warranty claims likely to arise on the sale of effected by the appellant and to cover up that expenditure. Since the provision made was for Rs.10,18,800 which exceeded the actual expenditure, the appellant revised Rs.5,00,246 as reversal

of excess provision. Consequently, the assessee claimed deduction in respect of the net provision of Rs.5,18,554 which was disallowed by the Assessing Officer on the ground that the liability was merely a contingent liability not allowable as a deduction u/s.37 of the Act. This decision was upheld by the Commissioner of Income-tax (Appeals).

On appeal, the Supreme Court held that in the case of manufacture and sale of one single item, the provision for warranty could constitute a contingent liability not entitled to deduction u/s.37 of the said Act. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past events of defects being detected in some of such items lead to a present obligation which results in an enterprise having no alternative to settling that obligation in the present case.

The appellant has been manufacturing valve actuators in large numbers. The statistical data indicated that every year some of these manufactured actuators are found to be defective. The statistical data over the years also indicated that being sophisticated item no customer is prepared to buy a valve actuator without a warranty. Therefore, the warranty became integral part of the sale price of the valve actuators. In other words, the warranty stood attached to the sale price of the product. Therefore, the warranty provision was needed to be recognised because the appellant was an enterprise having a present obligation as a result of past events resulting in an outflow of resources. Also, a reliable estimate could be made of the amount of the obligation.

The Supreme Court observed that there are following options for accounting the warranty expense :

(a) account warranty expense in the year in which it is incurred;

(b) to make a provision for warranty only when the customer makes a claim; and

(c) to provide for warranty at certain percentage of turnover of the company based on past experience (historical trend). According to the Supreme Court, the first opinion is unsustainable since it would tantamount to accounting for warranty expenses on cash basis, which is prohibited both under the Companies Act as well as by the Accounting Standards which require accrual concept to be followed. In the present case, the Department is insisting on the first option which, as stated above, is erroneous as it rules out the accrual concept. The second option is also inappropriate since it does not reflect the expected warranty costs in respect of revenue already recognised (accrued). In other words, it is not based on the matching concept. Under the matching concept, if revenue is recognised the cost incurred to earn that revenue including warranty costs has to be fully provided for. When valve actuators are sold and the warranty costs are an integral part of that sale price, then the appellant has to provide for such warranty costs in its account for the relevant year, otherwise the matching concept fails. In such a case the second option is also inappropriate.

Under the circumstances, the third option is the most appropriate because it fulfils accrual concept as well as the matching concept.

Reader's Note:

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(4) Principles of commercial expediency

- The judicial outlook in viewing a particular expenditure as revenue expenditure is gaining new dimensions with the passage of time and the change in the nature of expenditure incurred by the assessees as demanded by the ever changing common principles of commercial expediency and business prudence.

- To illustrate, an assessee company, engaged in the promotion of residential colonies, claimed deduction of the expenses incurred in the construction of a school. It was held that the construction of the school building has been made with a view to persuade buyers to purchase plots in the colony promoted by the assessee.
- Therefore, it is revenue in nature and deductible as such. Following are the more decisions on same line.

Case Study 27

CITv. Hari Vignesh Motors P. Ltd. [2006] 282 ITR 0338 (Mad.)

Conclusion

The assessee was a dealer in two-wheelers manufactured by TVS Suzuki Ltd. It was carrying on its business in leasehold premises. The assessee constructed a ground floor above the existing basement floor according to the specifications given by TVS Suzuki Ltd. to all its dealers. The assessee claimed the expenses incurred for construction as revenue expenditure for the relevant assessment year. The High Court observed that in view of the requirements of the business, the assessee had undertaken the construction. The assessee did not acquire any capital asset by incurring the expenditure. As per the stipulation in the lease deed, reimbursement of such expenditure from the owner of the premises was also not possible. The High Court, therefore, held that the expenditure was revenue in nature and can be allowed as deduction.

Reader's Note:

Case Study 28

CIT v Coats Viyella India Ltd [2002] 124 taxman 797 (Mad)

Conclusion

The taxpayer, a company, contributed funds to the government for building a new bridge as the old bridge had become unserviceable. The bridge was essential for providing access to the company's factory to the workmen and for movement of goods.

On a reference, the High Court held that the bridge was not owned by the company. The new bridge was build by the government. The payment made by the company was an outgo for which it did not receive any value addition to any of its assets. The bridge merely facilitated the access of the workmen to the company's factory and their return home and the movement of goods to and from the factory. The High Court followed the Supreme Court's decision in L H Sugar factory & Oil Mills (P) Ltd. v. CIT [1980] 125 ITR 293 and held that the payment made by the company was revenue in nature.

Reader's Note:

Case Study 29

CIT v. Laxmi Talkies (2006) 151 Taxman 99 (Guj.)

Conclusion

The assessee, a registered firm, carrying on business of exhibiting films in leased premises, incurring expenditure on account of stamp duty, interest etc. in addition to expenditure on renovation and repairs of cinema hall, claimed such expenditure as revenue expenditure. The High Court held that, since the expenditure would help the firm to increase its revenue by attracting more customers to

cinema hall without bringing into existence any new asset or benefit of enduring nature, the expenditure incurred was revenue expenditure.

Reader's Note:

Case Study 30

CIT v. Southern Roadways Ltd. (2006) 282 ITR 379 (Mad)

Conclusion

Up-gradation of computers by changing certain parts thereby enhancing the configuration of the computers for improving their efficiency but without making any structural alternations is not of enduring nature. The expenditure incurred by the assessee had therefore to be treated as revenue expenditure.

Reader's Note:

Case Study 31

CIT vs. Crompto Engineering. Co. Ltd.

Conclusion

Expenditure incurred in obtaining report of consultant to improve efficiency of the business by employing better methods and re-organising the business, was held to be of revenue character.

Reader's Note:

Case Study 32

CIT v. Hotel Control (P.) Ltd. June'04 (Uttranchal)

Conclusion

In this case, the assesee was a company, running hotel at mussoorie which is a hilly area. The hotel was spread over 12 acres of land having 100 suits and the structure was very old. The climatic conditions of Mussorrie are very severe. Generally Mussorrie gets heavy rainfall and, therefore, the assessee was required to incur expenditure at regular intervals in order to maintain and upkeep the hotel, i.e. on repair and maintenance of building, compound, furniture and maintenance of hotel. The high court held that assessee was required to incur expenditure at regular intervals due to weather conditions prevailing in Mussorrie. Hence, the expenditure incurred to maintain and upkeep hotel is in the nature of "current expenditure" and thus allowed as revenue expenditure.

Reader's Note:

(5) Expenditure on welfare of employees

Case Study 33

CIT v. Madras Refinaries Ltd. Apr.'04 (Madras)

Conclusion

Is monies spent by assessee-Refinery, for drinking water facilities in its vicinity and giving aid to school for benefit of local residents, deductible? –Held, yes.

Facts of the case are as under:-

The assessee is a public limited company. As a good corporate citizen and as a measure of gaining goodwill of the people living in and around its industry, which is to some extent a polluting industry, it provided funds for establishing drinking water facilities to the residents in the vicinity of the refinery and also provided aid to the school run for the benefit of the of those local residents. The Assessing Officer declined to allow that expenditure on the ground that it was not an item of expenditure incurred by the assessee for earning the income. The Tribunal, however, on examining the records, allowed the entire amount claimed as deduction.

The High Court observed that the concept of business is not static. It has evolved over a period of time to include within its fold the concrete expression of care and concern for the society at large and the people of the locality in which the business is located in particular. Further, to be known as a good corporate citizen brings goodwill of the local community, as also with the regulatory agencies and the society at large, thereby creating an atmosphere in which the business can succeed in a greater measure with the aid of such goodwill. In this case, the High Court upheld the order of the Tribunal allowing deduction for the amount spent on bringing drinking water to the locality and in aiding a local school.

Reader's Note:

Case Study 34

Assam Brook Ltd. v. Commissioner of Income-tax (2004) 139 Taxman 229.

Rallis Ltd. was situated in a remote place and its employees were the members of a club. The club was the only source of recreation to the employees. Rallis Ltd. paid a sum of Rs.5 lakhs to the club for renovation and repairs of the club building which had been damaged. Rallis Ltd. claimed deduction of the same as business expenditure. Discuss whether its claim is tenable in law?

Conclusion

This issue came up for consideration before the *Calcutta High Court in* ***Assam Brook Ltd. v. Commissioner of Income-tax (2004) 139 Taxman 229*****.** The High Court observed that since the company was situated in a remote place, the club was the only source of recreation for its employees, who were also members of the club. So, if the assessee-company paid some amount for the upliftment/running of the club in an effective way, then such payment was made in the interest of the assessee, so that its employees remained happy and, consequently, the work of the assessee was not hampered in any way due to dissatisfaction on the part of the employees. As the payment of Rs.5 lakhs was made by the assessee to the club keeping its business interest in mind, the said payment must be held to be business expenditure, and accordingly, as per section 37 the assessee-company was entitled to get deduction. The claim of Rallis Ltd. is, therefore, tenable in law.

Reader's Note:

Case Study 35

Cheran Engineering Corporation vs. CIT

Conclusion

If a trust is created for welfare of employees, contribution made to the trust means a contribution for welfare of employees and it is allowable as deduction. Sum paid directly to employees for agreeing to do work-strike-free, at the rate prescribed on the basis of an agreement is also labour welfare expenditure and is allowable as business expenditure.

Reader's Note:

Case Study 36

CIT vs. Sakthi Textiles Ltd

Conclusion

Expenditure incurred on the installation of the dust extraction plant, to protect the health of the workmen was held to be revenue expenditure

Reader's Note:

Case Study 37

CIT v. Rajasthan Spg. & Wvg. Mills Ltd.

Business expenditure : A.Y. 1992-93 : Assessee company donated bus to an institute where children of its employees were studying : Cost of bus is revenue expenditure deductible u/s.37(1) of Income-tax Act, 1961

Conclusion

In the previous year relevant to the A.Y. 1992-93, the assessee company donated a bus to an institute where the children of its employees were receiving education. In the A.Y. 1992-93, the assessee company claimed deduction of the cost of the bus as business expenditure u/s.37(1) of the Income-tax Act, 1961. The Assessing Officer disallowed the claim holding that it was a case of donation and not an admissible expenditure, since the school was neither owned by the company, nor the entry to the school was restricted to its staff members' children. The Tribunal allowed the assessee's claim.

On appeal, the Rajasthan High Court upheld the decision of the Tribunal and held as under :

"The motivation of expenditure incurred for acquiring the bus and surrendering it to school had not been found to be other than what had been stated by the assessee i.e., the expenses were incurred for the benefit of welfare of the children of staff/workmen of the company as a part of employees welfare expenses incurred for the purpose of securing healthy services for staff members. The Tribunal was right in holding the expenses to be incurred wholly and exclusively for the purposes of assessee's business and since the assessee had not acquired any asset, it was not capital expenditure either and, therefore, the assessee was entitled to claim deduction in full u/s.37(1)."

Reader's Note:

(6) Expenditure of personal nature – Always Debatable

Case Study 38

Sayaji Iron & Engg. Co. v. CIT (High Court of Gujarat)

Conclusion

Where, as per terms and conditions on which directors were appointed, they were entitled to use assessee company's vehicles for their personal use, Assessing Officer was not justified in disallowing 1/6th of expenditure incurred by assessee- company on maintenance of its vehicles.

The Gujarat High Court further observed that company being an artificial person cannot have any personal expenditure so as to disallow on the ground that it is not incurred wholly and exclusively for the purpose of business

Reader's Note:

Case Study 39

CIT v. R.K.K.R. Steels P. Ltd. [2002] (Mad.)

Conclusion

Section 37(1) – Assessee company incurred an expenditure on foreign travel in connection with education of son of director and claimed the same as deduction u/s 37(1). Not only that, this son of director later on joined as director of assessee–company. The court observed that this being an expenditure not wholly and exclusively in connection with business and therefore not allowed as deduction.

Reader's Note:

Case Study 40

CIT v. Ram Bahadur Thakur Ltd. (2004) 138 Taxman 30 (Ker.)

Is it the obligation of the assessee to prove the business expediency of foreign travel by the wives of the directors?

Conclusion

FACTS

The assessee claimed allowance of foreign travel expenses of the directors and their wives. The Assessing Officer disallowed the claim on the ground that the expenditure was not incurred wholly and exclusively for the purpose of the business. The Commissioner (Appeals), however, allowed the claim of the assessee relying on some decisions of the Tribunal wherein in similar circumstances, traveling expenses incurred by the wife of the director were considered to be admissible expenses. The Tribunal upheld the order of Commissioner (Appeals).

DECISION

The High Court observed that the Tribunal had not given reasons for the admissibility of the traveling expenses of the wives of the directors. **Mere statement from the company that the traveling expenses incurred by the wives of the directors were considered to be admissible expenses does not mean that this is not personal expenditure.** The assessee has to prove that it is not to be treated as a personal expenditure. **The High Court reversed the order of the Tribunal holding that it is the assessee's**

obligation to prove the business expediency of overseas travel by the wives of the directors. If the assessee fails in this regard, then such expenditure would be disallowed.

Reader's Note:

Case Study 41

CIT v. Alfa Laval (I) Ltd. (Bom.)

Expenditure on foreign trip of wife of company president : Allowable as business expenditure

Conclusion

The assessee company had incurred certain expenditure on foreign trips of the wife of the company's president. The assessee company claimed deduction of the said expenditure as business expenditure. The Assessing Officer disallowed the claim. The Tribunal allowed the claim.

On reference, the Bombay High Court upheld the decision of the Tribunal and held as under :

(i) It is well settled that the items of expenditure are to be considered from the point of view of a normal, prudent businessman. The test would merely mean that the Court would place itself in the position of a businessman and find out whether the expenses incurred could be said to have been laid out for the purpose of the business. It seemed that in the ultimate analysis, the matter would depend on the status of the parties as spelt out and the nature of character of the trade or venture, the purpose for which the expenses were incurred and the object which was sought to be achieved in incurring those expenses.

(ii) Applying normal, prudent businessman's approach, the expenses incurred by the assessee on foreign trips of the wife of the company's president could be said to be for the purposes of the business of the assessee-company. Considering the concurrent finding of the fact recorded by the lower authorities, the expenditure could be allowable as deduction while computing the profit and gains of the business."

Reader's Note:

(7) Expenditure incurred for any purpose, which is an offence or is prohibited by law

One of the conditions to claim expenditure under section 37(1) is that it should not have been incurred for any purpose which is an offence or is prohibited by law. To digest this, one should go through the following decisions of courts.

Case Study 42

Standard Batteries Ltd., vs. CIT, (1994) (SC); Swadeshi Cotton Mills Co. Ltd., vs. CIT, (1997) (SC) and Malwa Vanaspati and Chemical Co. vs. CIT, (1996) (SC).

Conclusion

Where imposition of **penalty** is not for delay in payment of Sales-tax but **for contravention of provisions of Central Sales-tax Act**, **the levy is not compensatory and therefore not deductible. If the levy is compensatory in nature, the levy is fully allowable. Where it is composite levy, that portion which is compensatory is allowable find that portion which is penal is to be disallowed.**

Reader's Note:

Case Study 43

Lakshmandas Mathwadas vs. 677(1997) 254 ITR 799 (SC)

Conclusion

Interest on arrears of sales tax or on the outstanding balance of sales tax is not penal. It is compensatory in nature and is an allowable deduction in computing the profits of a business

Reader's Note:

Case Study 44

CIT vs. Ahmedabad Cotton Manufacturing Co., (1993) (SC).

Conclusion

Though the sum to be paid for default in fulfilling the export obligation may be described as penalty, it is a business expenditure incurred wholly and exclusively for the purpose of assessee's business. Therefore it is deductible as a business expenditure.

Reader's Note:

Case Study 45

CIT v. Mamta Enterprises (Karnataka HC)

Conclusion

In the given case, assessee is in the business of building apartments and selling the same, claimed deduction of compounding fees paid to Municipal Corporation to regularize the unathorised construction. The high court held that it cannot be allowed as deduction in view of the explanation to section 37 which clearly declares that expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be allowed as business expenditure.

Reader's Note:

Case Study 46

CIT V. Catholic Syrian Bank Ltd. (2003) (Ker.)

Conclusion

One of the important test to determine whether the levy is compensatory or penal in nature is whether for the non-compliance of the provisions any criminal liability or prosecution is provided. If any criminal liability or prosecution is provided, the levy is surely penal in nature

Reader's Note:

Case Study 47

T.A. Quereshi v. CIT (SC) (2006) 287 ITR 547

Conclusion

The explanation to s. 37 has really nothing to do with the present case as it is not a case of a business expenditure, but of business loss – Once it is found that the heroine seized formed part of the stock in

trade of the assessee, it follows that the seizure and confiscation of such stock in trade has to be allowed as a business loss – Law is different from morality.

Reader's Note:

Circular No. 5/2012 dated 1-8-2012

Inadmissibility of expenses incurred in providing freebees to medical practitioner by pharmaceutical and allied health sector industry

Section 37(1) provides for deduction of any revenue expenditure (other than those falling under sections 30 to 36) from the business income if such expense is laid out or expended wholly or exclusively for the purpose of business or profession. However, the Explanation below section 37(1) **denies claim of any such expenses, if the same has been incurred for a purpose which is either an offence or prohibited by law.**

The Central Board of Direct Taxes, considering the fact that the claim of any expense incurred in providing freebees to medical practitioner is in violation of the provisions of Indian **Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002,** has clarified that the expenditure so incurred shall be inadmissible under section 37(1) of the Income-tax Act, 1961, being an expense prohibited by the law. The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebees and claimed it as a deductible expense in its accounts against income.

This circular has also clarified that a sum equivalent to **value of freebees enjoyed by the aforesaid medical practitioner or professional associations is also taxable as business income or income from other sources,** as the case may be, depending on the facts of each case.

Case Study 48

X & Co. Diagnostic Centre P Ltd. has claimed referral fee paid to doctors as revenue expenditure for the assessment year 2017-18. Tax has been deducted under section 194H of the Income-tax Act, 1961 for the said payments. The Assessing Officer proposes to disallow such expenditure.

Examine the correctness of the action of the Assessing Officer.

Conclusion

As per Explanation to section 37(1), any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be eligible for deduction under the head PGBP.

As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive or offer to give, solicit or receive any gift, gratuity, commission or bonus in consideration for referring any patient for medical treatment.

Applying the rationale and considering the purpose of Explanation to section 37(1), the assessee would not be entitled to deduction of such payments made in contravention of law or opposed to public policy or have pernicious consequences to the society as a whole. This view has also been expressed by the Punjab & Haryana High Court in CIT vs. Kap Scan and Diagnostic Centre P Ltd. (2012) 344 ITR 476.

Thus, the action of the Assessing Officer in disallowing the referral fee paid by X & Co. Diagnostic Centre P. Ltd. to doctors is correct irrespective of the fact that the tax has been deducted under section 194H or not.

Reader's Note:

(8) Capital or Revenue Expenditure

Case Study 49

Keral High court in case of CIT v. Hotel Shah and Co. [2005] 275 ITR 195

B. Ltd., the holding company of A. Ltd., had entered into an agreement by which the textile unit belonging to it was transferred to A. Ltd. The agreement also stipulates for the protection of service conditions and continuity of service of the workmen employed in the textile unit so transferred to/taken over by A. Ltd. B. Ltd. delivered the possession of the properties to A. Ltd. and also transferred all the employees working in the textile unit with the benefit of continuity of service and protection of service conditions. A. Ltd. claimed deduction for the amount of gratuity payment in respect of the workers of erstwhile textile unit of B. Ltd., who had retired during the relevant previous year. The Assessing Officer disallowed this claim of A. Ltd. on the ground that the liability towards gratuity payment to the employees of erstwhile company for the period prior to the takeover of the unit is not revenue expenditure but is a capital expenditure.

Discuss the correctness of the action of the Assessing Officer.

Conclusion

The facts given in the problem are identical to the facts of the case decided by the Madras High Court in Sree Akilandeswari Mills Pvt. Ltd. v. Dy. CIT (2005) 274 ITR 1, where the Court has held that "the company, by virtue of the deed of transfer, had taken over the liability towards the employees of the transferor company and on the date of transfer, the liability relating to the gratuity was an ascertained liability on the basis of actuarial valuation. This also formed an integral part of the sale consideration to be discharged by making actual payment to the employee in subsequent years. The payment of gratuity, thus, was in the nature of a capital expenditure."

In the given problem, A. Ltd., by virtue of the deed of transfer, had taken over the possession of the textile unit of B. Ltd. with a liability of the transferor company towards the continuity of service and the protection of service conditions of the employees on the date of transfer. The gratuity liability was, thus, also an ascertained liability on the basis of actuarial valuation payable to the employees retiring after the date of transfer.

Hence, in this case, the expenditure incurred by A Ltd. towards discharge of the gratuity liability of the employees of the unit taken over from B Ltd., is a capital expenditure. Therefore, the reasoning of the Assessing Officer is correct.

Reader's Note:

Case Study 50

Keral High court in case of CIT v. Hotel Shah and Co. [2005] 275 ITR 195

Highland hotels Pvt. Ltd. paid building tax under the Kerala Building Tax Act, 1975 and claimed deduction for the same under section 30 or 37(1) of the Income Tax Act. However, on referring section 5 of the Kerala Building Tax Act, 1975, this tax is required to be paid to perfect title to the building and also required to be paid once. Therefore, the A.O. disallowed the claim and treated the same as a part of cost of Building. Whether action of A.O. is justified?

Conclusion

This issue came up before **Keral High court in case of CIT v. Hotel Shah and Co. [2005] 275 ITR 195.** The Court observed that as per section 5 of the Keral Building Tax Act, 1975 , this tax amounts to perfect the title of the building and also it is one time levy. While Section 30 allows deduction of municipal tax which is of recurring nature. Therefore, held that it cannot be allowed as deduction under section 30 of the Income Tax Act. The court further held that considering the nature of tax it cannot be of revenue nature and therefore, cannot be allowed as deduction under section 37(1) of the Act also. Thus, action of A.O. is in line with the decision of Kerala High Court.

Reader's Note:

Case Study 51

Chimo Agencies Pvt. Ltd. v. CIT June'04 (M.P)

Conclusion

In the present case, the assessee had taken building on rent and in the relevant accounting year it entered into an agreement to purchase the said building. As per the terms and conditions of this agreement, the assessee was not required to pay any rent to the owner as he was entitled to interest accrued on the advance payment. He incurred repairs to the building thereafter and claimed the same as revenue expenditure. The high court held that repairs made after execution of agreement to sale under belief that assessee would own property very soon, could not be allowed as revenue expenditure.

Reader's Note:

(9) Incurred for the purpose of business

Case Study 52

ACIT v. Rajasthan Spinning & Weaving Mill Ltd. (2004) 137 Taxman 367

The assessee was a manufacturer of textiles who made contribution towards export development fund. The assessee claimed that in order to augment its own export sales and give competitive edge to its marketing, it had contributed to the fund in its own business expediency, with the object of increasing opportunity of export of goods manufactured by it and to earn the subsidy. The assessee, therefore, claimed deduction on account of the same. Is the contention of the assessee correct?

Conclusion

This question came up for consideration before the *Rajasthan High Court in* ***ACIT v. Rajasthan Spinning & Weaving Mill Ltd. (2004) 137 Taxman 367****.* The Court observed that the fund was set up to promote

export of textiles and therefore contribution to such fund had direct nexus to the advancement of the assessee's business, Participation in any trade, association or fund set up for advancement of business, which is also carried on by the assessee, is primarily for advancing assessee's own business and not for philanthropic purposes. The High Court held that such expenses were incurred and laid out wholly and exclusively for the purpose of the assessee's business, and hence were allowable as deduction under section 37(1). Therefore, in this case, the contention of the assessee is correct.

Reader's Note:

(10) Expenditure incurred on raising shares/debentures etc.

Case Study 53

Shree Digvijay Cement Co. Ltd. vs. CIT 138 ITR 45 (Guj)

Conclusion

Expenditure incurred by a company in raising new shares is a capital expenditure

Reader's Note:

Case Study 54

Brooke Bond India Ltd. V. CIT 225 ITR 798 (SC)

Conclusion

Expenditure for raising additional capital by issue of ordinary shares is a capital expenditure

Reader's Note:

Case Study 55

Punjab State Industrial Development Corporation Ltd. Vs. CIT 93 Taxman 5 (SC)

Conclusion

Registration fee paid for increase in authorized share capital is a capital expenditure

Reader's Note:

Case Study 56

CIT v General Insurance Corporation (2006) 286 ITR 232(SC)

Conclusion

Although expenditure incurred in connection with increase in the authorised capital shall be a capital expenditure but expenditure incurred by the company on account of stamp duty and registration fee in connection with issue of bonus shares shall be allowable expenditure as issue of bonus shares does not result in any inflow of fresh funds or increase in the capital employed

Reader's Note:

Case Study 57

CIT v. Motor Industries Co. Ltd. 229 ITR 137 (Kar)

Conclusion

Expenditure incurred in connection with right issue a capital expenditure

Reader's Note:

Case Study 58

India Cements Ltd. v. CIT (1966) 60 ITR 52 (SC)

Conclusion

The expenditure on issue of debentures is not in the nature of capital expenditure and is laid out or expended wholly and exclusively for the purpose of the assessee's business and is therefore, allowable as a deduction. The act of borrowing money is incidental to the carrying on of business, the loan obtained is not an asset or an advantage of enduring nature, the expenditure is made for securing the use of money for a certain period, and it is irrelevant to consider the object with which the loan was obtained

Reader's Note:

Case Study 59

Madras Industrial Investment Corporation Ltd. 225 ITR 802 (SC)

Conclusion

Where company issues debentures or bonds at a discount, the liability to pay discounted amount is an "expenditure" under section 37 (1) but it shall be spread over the period for which debentures remain outstanding

Reader's Note:

Case Study 60

Universal Cables Ltd. V. CIT 243 ITR 371 (Cal)

Conclusion

Liability to pay premium on issue price of debenture by a company is not a contingent liability and is to be allowed as revenue expenditure but not as one time expenditure at time it is incurred but is to be spread over entire period of redemption of debenture

Reader's Note:

Case Study 61

Rajsthan High Court in CIT v. Secure Meters Ltd. 175 Taxman 567

Conclusion

Rajsthan High Court in CIT v. Secure Meters Ltd. 175 Taxman 567 held that debenture issued is a loan and thus, expenditure incurred in issuing debentures is deductible irrespective of the fact whether it is convertible or not

Reader's Note:

The table given below highlights whether expenditure for raising capital / loan is deductible under section 35 D or Section 37(1)

Different Expenses	Incurred by a new concern before commencement of business	Incurred by an existing concern after commencement of business
Expenditure on issue of bonus shares	Sec. 35D	Sec. 37(1)
Expenditure on issue of shares(Not being a bonus share	Sec. 35D	Sec. 35D
Expenditure on issue of debentures	Sec. 35D	Sec. 37(1)
Expenditure on raising long term/short term loan	Sec. 35D	Sec. 37(1)

(11) Summary of frequently tested issues on section 37(1)

Following are debited to profit and loss account. Discuss the allowability of the same while computing income under the head "PGBP" with reasons.

Sr. No.	Particulars of debit	Allowable / Disallow	Reason / Remark
1.	Compensation of Rs. 2,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after receipt of 50% of appliances	Disallow	Compensation paid for breach of a contract for supply of a capital asset is in the nature of capital expenditure as held by the **Supreme Court in case of Swadeshi Cotton Mills Co. Ltd. vs. CIT (1967) 63 ITR 65.**
2.	Wines and liquor imported and held as stock-in trade amounting to Rs. 5 lac. Entire stock so held were confiscated by the Custom Officer being an illegal import hence written off.	Allowable	**The Apex Court in case of Dr. T.A. Quereshi vs CIT (2006) 287 ITR 547** observed that loss of stock-in-trade has to be considered as a trading loss. Business loss is allowable on ordinary commercial principles. Explanation to section 37(1) is not relevant here since it is not a case of business expenditure but one of business loss.
3.	Retrenchment compensation paid to employees of one of the units closed down during the year Rs.10,00,000.	Allowable	Compensation paid to workers **on closing one of units** be allowed to be deducted when there was unity of control and management of various units and all were assessed in assessee's hands as one business. - Jayshree Tea and Industries Ltd. v. CIT [2005] (Cal.); CIT V. JK Cotton Spinning & Weaving Co. Ltd. (2005) 145 Taxman 591 (All)

4.	Rs. 5 lacs paid to N. Ltd, towards feasibility study conducted for examining proposals for technological advancement relating to the existing business. The project was abandoned later.	Allowable	**The Delhi High Court, in CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594**, observed that in such cases, whether or not a new business/asset comes into existence would become the relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature.
5.	Expense of Rs. 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed and the project was abandoned. This project is not related to the existing business of the assessee.	Disallow	Where expenditure is incurred for a project not related the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature **McGaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.)**
6.	Commission of Rs. 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act	Allowable	Commission paid to a recovery agent for realisation of a debt is an allowable expense under section 37(1) as per **DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All)**
7.	Rs. 12 lakhs paid towards course fee and hostel expenses for MBA course of a close relative of a director. The relative is not in employment with the company.	Disallow	Such expenditure is not incurred wholly and exclusively for the purposes of business and therefore not deductible under section 37 **Enkay (India) Rubber Co. Pvt. Ltd v. CIT (2003) 263 ITR 521 (Del).**
8.	Rs. 3 lakhs spent on gift items distributed to various dealers under the company's sales incentive scheme.	Allowable	Expenses on distribution of gift items to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) **[CIT v. Avery Cycle Industries Ltd. (2008) 298 ITR 239 / 296 ITR 393 (Punjab & Haryana)].**
9.	Rs. 25 lacs paid for the higher studies of the director's son abroad, with a stipulation that he would be appointed as a trainee	Disallow	Since there is no evidence of existence of any “apprentice training scheme”, the expenditure of Rs. 25 lakhs incurred in respect of higher studies abroad for the

	in the company under "apprentice training scheme" where there is no evidence of existence of such scheme		director's son is not allowable as deduction as there is no nexus between the education expenditure incurred abroad for the director's son and the business of the assessee. **Bombay High Court in Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286.**
10.	Secret commission of Rs. 3 lacs was paid.	Disallow	As per Explanation to section 37(1), any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. Therefore, payment of secret commission, if it is established as a payment for any purpose which is an offence or which is prohibited by law, cannot be allowed as deduction. **Tarini Tarpauline Productions v. CIT (2002) 254 ITR 495 (Ori.)**
11.	Purchased a brand new bus for Rs. 15 lacs and donated to a school where the employees' children were studying and debited the same to the Workmen and Staff Welfare Account.	Allowable	The expenditure incurred for acquiring a new bus and donating it to the school is for the welfare of the children of staff/workmen of the company. Such expenditure is a part of employees' welfare expenses incurred for the purpose of securing healthy services for staff members. Therefore, such expenses were incurred wholly and exclusively for the purpose of the business. Since the bus had been donated to the school, no benefit of enduring nature was derived by the assessee as the right of ownership was transferred to school. Hence, it is not a capital expenditure. Since such expenditure is incurred wholly and exclusively for the purpose of business and is not capital in nature, S Ltd. is entitled to claim deduction in full under section 37(1). **Rajasthan High Court in CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408.**

12.	Legal fees incurred in defending title to factory premises	Allowable	Legal fees incurred in defending title to factory premises is an expenditure incurred wholly and exclusively for the purpose of business and is, therefore, allowable under section 37(1). **Supreme Court in Dalmia Jain & Co. Ltd. v. CIT (1971) 81 ITR 754.**
13.	Interest paid on arrears of GST	Allowable	Interest paid on arrears of sales tax is not penal in nature but is compensatory in character and is an allowable deduction under section 37(1) **Supreme Court in Lachmandas Mathurdas v. CIT (2002) 254 ITR 799.**
14.	Penalty for delay in filing of GST returns	Disallow	Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – **CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)**
15.	Rs. 2,50,000 incurred on public issue of shares. However, the public issue could not materialize on account of non-clearance by SEBI	Disallow	Share issue expenses incurred by the company constitutes a capital expenditure, even though it could not go in for the public issue on account of non-clearance by SEBI. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts **Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545 (Mad.)**
16.	Rs. 1,00,000 paid as compounding fee for violation of provisions of Kerala Building Act.	Disallow	The amount paid for compounding an offence is inevitably a penalty and the mere fact that it has been described as compounding fee cannot, in any way, alter the character of the payment which is in the nature of penalty. Hence, the same is not allowable as revenue expenditure in view of explanation to section 37(1) **Millenia Developers P Ltd. v. Deputy CIT (2010) 322 ITR 401 (Kar.).**

17.	The company lost cash of Rs. 25,00,000 due to theft when it was withdrawn from bank and taken to administrative office.	Allowable	In order to determine whether any loss from theft, dacoity, embezzlement, etc., is deductible or not, what is material is whether the loss incurred by theft, dacoity, etc., is incidental to the carrying on of the business. It does not make much difference whether such act is committed by the employees of the assessee or by strangers **G.G. Dandekar Machine Works Ltd. v. CIT (1993) 202 ITR 161 (Bom.)**
18.	Rs.5 lakhs, being expenses incurred on the travelling of the wife of Managing Director, who accompanied him on tour to Beijing on invitation of Trade & Commerce Chamber, China.	Allowable	Expenses on travelling of wife of Managing Director to Bejing on the invitation of Trade and Commerce Chamber, China, is an allowable expense on the grounds of commercial expediency and business consideration. **Hero Honda Motors Ltd. v. CIT (2005) 3 SOT 572 (Delhi)**
19.	Legal charges in connection with alteration of the Articles of Association Rs. 1.50 lacs	Allowable	Legal charges of for amendment of Articles of Association is deductible. **Allahabad High Court in CIT vs Modi Spinning & Weaving Mills Co Ltd. (1973) 89 ITR 304.**
20.	An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to Rs. 6.00 lacs to his family members	Allowable	Payment of gratuity on account of death of an executive while on business trip is allowable as deduction. **CIT vs. Laxmi Cement Distributors (P) Ltd. (1976) 104 ITR 711 (Gujarat)**
21.	Rs. 2 lakh on alteration of Memorandum of Association in connection with increase in authorized capital.	Disallow	Rs. 2 lakhs, being legal expenses in relation to alteration of memorandum in connection with increase in Authorised Capital is directly related to expansion of the capital base of the company and is, hence, a capital expenditure. Therefore, the same is not allowable as deduction. It has been so held in **Punjab State Industrial Development Corporation Ltd. vs. CIT (1997) 225 ITR 792 (SC).**
22.	Rs. 10 lakh on issue of bonus shares	Allowable	There is no fresh inflow of funds or increase in capital employed on account of issue of bonus shares and there is only reallocation of the company's fund. Consequently, since

			there is no increase in the capital base of the company, legal expenses of Rs. 10 lakhs in connection with issue of bonus shares is a revenue expenditure and is hence, allowable as deduction. It has been so held by Apex Court in case of **CIT vs. General Insurance Corpn. (2006) 286 ITR 232.**
23.	Interest of Rs. 3,000 paid on an overdraft of Rs. 1 lac taken for making payment of installment of advance tax of Rs. 1.25 lacs.	Disallow	Interest on the overdraft taken for making payment of installment of advance tax is not allowable under section 37(1) since it is not an expenditure wholly and exclusively incurred for the purpose of business as held by the **Apex Court in the case of East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627.**

5.58 CRITICAL JUDICIAL RULINGS – SECTION 68

Case Study 62

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

Solution

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

The High Court observed that under Section 68 of the Act if an assessee fails to explain the nature and source of credit entered in the books of account of any previous year, the same can be treated as income. In this case, the amount sought to be treated as income of the firm is the contribution made by the partners to the capital. In a way, the amount so contributed constitutes the very substratum for the business of the firm and it is difficult to treat the pooling of such capital as credit. It is only when the entries are made during the course of business, they can be subjected to scrutiny under section 68. Where the firm explains that the partners have contributed capital, section 68 cannot be pressed into service. At the most, the Assessing Officer can make an enquiry against the individual partners and not the firm when the partners have also admitted their capital contribution in the firm.

The High Court made reference to decision in the case of CIT v. Anupam Udyog 142 ITR 130 (Patna) where it was held if there are cash credits in the books of the firm in the accounts of the individual partners and it is found as a fact that cash was received by the firm from its partner, then, in the absence of any material to indicate that they are the profits of the firm, the cash credits cannot be assessed in the hands of the firm, though they may be assessed in the hands of individual partners.

Reader's Note:

6 – CAPITAL GAINS

UNIT A – FUNDAMENTALS OF CAPITAL GAINS

6.1 WHEN CAPITAL GAIN IS ATTRACTED?

Section:- 45(1)

By virtue of section **45 (1)**, if following conditions are satisfied, then capital gain is attracted—

1. There must be a capital asset.
2. The capital asset is transferred by the assessee during the previous year.
3. Any profit or gain arises as a result of such transfer.
4. Such profit or gain is not exempt from tax under section 54 to section 54GB.

6.2 DEFINITION OF CAPITAL ASSET

Section:- 2(14)

The expression "capital asset" means

(a) property of any kind held by an assessee, whether or not connected with his business or profession.

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992.

However, the following assets are excluded from the definition of "capital assets"-

a. any stock-in-trade, consumable stores or raw materials held for the purposes of business or profession;

b. personal effects of the assessee, that is to say, movable property including wearing apparel and furniture held for his personal use or for the use of any member of his family dependent upon him.
   However, following personal effects are treated as capital asset.
   (i) Jewellery
   (ii) archaeological collections
   (iii) drawings
   (iv) paintings
   (v) sculptures
   (vi) work of any art

c. agricultural land in India;

d. 6 ½ per cent Gold Bonds 1977, 7 per cent Gold Bonds, 1980, National Defence gold Bonds 1980;

e. Special Bearer Bonds, 1991 ; and

f. Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015.

6.3 DEFINITION OF TRANSFER

Section:- 2(47)

It includes:

(a) Sale, exchange or relinquishment of the asset or
"To relinquish" means to abandon / to give up the asset.

(b) The extinguishment of any rights therein or
"Extinguishment of rights in assets" means to give up the rights in asset.

1

Examples of relinquishments are: (i) giving up tenancy rights (ii) renouncement of right offer letter (iii) giving up the right to manufacture any article or thing (iv) giving up the right to carry on business.

(c) The compulsory acquisition thereof under any law.

(d) Conversion of capital assets into stock–in-trade

2

Mr. Kalyan owns jewelry in personal capacity. He started show room named "Kalyan Jewelers" of which he is proprietor. Mr. Kalyan then transferred his personal jewelry to this show room as stock-in-trade. Then it is called "Conversion of capital asset into stock-in-trade" and liable for capital gain under section 45 (2).

(e) Allowing the possession of any immovable property to be taken or retained in part performance of a contract.

(f) any transaction (whether by way of becoming a member of, or acquiring shares in a co- operative society, company or other association of persons or by way of agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of any immovable property.

(g) Maturity or redemption of a Zero Coupon Bonds.

6.4 LIST OF FEW TRANSACTIONS NOT TREATED AS TRANSFER

Section:- 46 and 47

(a) distribution of assets in kind of a company to its shareholders on its liquidation.

(b) any distribution of capital assets in kind by a Hindu undivided family to its members at the time of total or partial partition.

(c) any transfer of a capital asset under a will or an irrevocable trust or a gift .

(d) any transfer of a capital asset by a company to its wholly owned Indian subsidiary company.

(e) any transfer of a capital asset by a wholly owned subsidiary company to its Indian holding company.

(f) any transfer of a capital asset, being any work or 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 other such public museum or institution as may be notified by the Central Government.

(g) any transfer of land under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 by a sick industrial company which is managed by its workers' co-operative provided such transfer is made in the period commencing from the previous year in which the said company has become a sick company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

(h) 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.

(i) any transfer by way of conversion of preference shares of a company into equity shares of that company.

6.5 DEFINITION OF CAPITAL ASSET

Section:- 2(42A) – Effective from A.Y.2018-19

As per section 2(42A), a short-term capital asset means capital asset held by an assessee for not more than 36 months immediately prior to its date of transfer. However, in the following cases an asset, held for not more than 12 months, is treated as short-term capital asset-

(a) Equity or preference shares in a company (Listed in a recognized stock exchange)

(b) Securities listed in a recognized stock exchange in India.

(c) Units of UTI (whether listed or not)

(d) Units of an equity oriented fund (whether listed or not)

(e) Zero Coupon Bonds (whether listed or not)

Remark:

1. In case of unlisted shares (equity or preference), if transfer takes place on or after 1st April, 2016, the period of holding not exceeding 24 months, shall be taken into consideration instead of 36 months.
2. **In case of *an immovable property, being land or building or both,* if transfer takes place on or after 1st April, 2017, the period of holding not exceeding 24 months, shall be taken into consideration instead of 36 months.**

Practical 1

Mr. Jagmohan purchased residential building on 10th August, 2015. Thereafter, he sold out this building on 15th August, 2017. Determine the nature of asset.

Solution

Period of holding in respect of residential building exceeded 24 months. Hence, the residential building transferred by Mr. Jagmohan is a long term capital asset.

Reader's Note:

Practical 2

Discuss the nature of capital asset in the following cases

(a) Mr. Mohan purchased 1000 shares of Tata Motors Limited (Listed) on 10th August, 2016. Thereafter, he sold out these shares on 15th February, 2018. Determine the nature of assest.

(b) Does your answer differ in the point no. (b) above, if instead of shares of TATA Motor Limited, shares of Bye Bye Private Limited is given?

(c) Mr. Rajnikant purchased Bihar Government Security papers (not listed) on 10th July, 2015. He then transferred these papers on 14th August, 2017.

(d) Does your answer differ in the above problem, if, instead of Bihar Government Security papers, 100 debentures of Reliance Industries Limited (listed) is given?

Solution

(a) Period of holding of share of Tata Motors Limited is 18 months & 5 days which is exceeding 12 months. Hence, shares of Tata Motors Limited are long term capital assets.

(b) Period of holding of share of Bye Bye Private Limited is 18 months & 5 days which is not exceeding 24 months. Hence, shares of Bye Bye Private Limited are short term capital assets.

(c) Period of holding of unlisted Bihar Government Securities is 25 months & 4 days which is not exceeding 36 months. Therefore, such securities shall be considered as short term capital asset.

(d) Period of holding of debentures of Reliance Industries Limited (listed) 25 months & 4 days which exceeding 12 months. Hence, such securities shall be the long term capital asset.

Readers Note:

6.6 COMPUTATION OF CAPITAL GAIN

Sections:- 48

(1) Short Term Capital Gain

Particulars	Rs.
Find Out Full Value Of Consideration	xxx
Less : Expenditure incurred wholly and exclusively in connection with transfer	xxx
Net Consideration	xxx
Less: Cost Of Acquisition	xxx
Less: Cost Of Improvement	xxx
Short Term Capital Gain Before exemption	xxx
Less : Exemptions u/s 54B, 54D, 54G & 54GA	xxx
Short Term Capital Gain	xxx

(2) Long Term Capital Gain

Particulars	Rs.
Find Out Full Value Of Consideration	xxx
Less : Expenditure incurred wholly and exclusively in connection with transfer	xxx
Net Consideration	xxx
Less: Indexed Cost Of Acquisition	xxx
Less: Indexed Cost Of Improvement	xxx
Long Term Capital Gain before exemption	xxx
Less: u/s 54, 54B, 54D, 54EC, 54F, 54G, 54GA & 54GB	xxx
Long Term Capital Gain	xxx

6.7 WHAT IS THE CONCEPT OF "NOTIONAL COST" UNDER THE HEAD CAPITAL GAIN?

Section:- 49(1)

If a capital asset was acquired in any one of modes given below, then cost to the previous owner shall be taken as "cost of acquisition". There is no option in this regard.

(i) acquisition of property on any distribution of assets on the total or partial partition of a Hindu undivided family;

(ii) acquisition of property under a gift or will;

(iii) acquisition of property-
  (a) by succession, inheritance or devolution, or
  (b) on any distribution of assets on the liquidation of a company
  (c) under a transfer to a revocable or an irrevocable trust, or
  (d) on any transfer, by a wholly-owned Indian subsidiary company from its holding company, or
  (e) on any transfer
    - by an Indian holding company from its wholly-owned subsidiary company or
    - under the scheme of amalgamation, or
    - under demerger, by the resulting company from the demerged company
    - under the scheme of business reorganization of a cooperative bank
    - under the scheme of conversion of private company or unlisted company into LLP, or
    - under the scheme of conversion of firm / proprietorship firm into company.
    - Under the scheme of corporatization of stock exchange.

(iv) acquisition of property, by a Hindu undivided family where one of its members has converted his self-acquired property into joint family property after December 31, 1969.

6.8 PLATINUM PRINCIPLES FOR COMPUTING CAPITAL GAIN

Section:- 48

(a) If capital asset has been acquired by any mode referred to in section 49 (1), then in order to find out whether a capital asset is a short-term or long-term capital asset, the period of holding of the previous owner shall be taken into consideration.

(b) If capital asset has been acquired by any mode referred to in section 49 (1), then cost to the previous owner shall be taken as cost to the assessee.

(c) As per section 55 (2), if capital asset has been acquired either by the previous owner or by the taxpayer prior to April 1, 2001, then option is available to adopt fair market value as on April 1, 2001 as cost of acquisition. **Generally, taxpayer shall adopt cost or fair market value as on 1st April, 2001 whichever is higher as cost of acquisition.**

(d) As per section 51, if any advance, or other money received and forfeited by the taxpayer (not by the previous owner), the it shall be reduced from the cost for which the asset was acquired or from fair market value as on 1st April, 2001, as the case may be. **This rule is applicable for the advances received upto 31st March, 2014.**

(e) Cost of acquisition shall be indexed as per following formula:-

$$\frac{\text{Cost of acquisition} \times \text{Transfer year index}}{\text{Capital Asset Acquisition year index (See Note)}}$$

Note:- Following the decision of Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, assessee is entitled to claim indexation benefit from the previous year in which the capital asset was acquired by the previous owner.

(f) As per section 55 (1) (b), cost of improvement prior to 1st April, 2001, incurred either by the previous owner or by the taxpayer shall be completely ignored.

(g) Cost of improvement incurred either by the previous owner or by the taxpayer shall be indexed as per following formula:-

$$\frac{\text{Cost of improvement} \times \text{Transfer year index}}{\text{Improvement year index}}$$

Practical 3

In order to claim deduction of expenditure incurred in relation transfer, what is timing of incurring such expenditure?-

(a) At the time of transfer
(b) Before the date of transfer
(c) After the date of transfer
(d) None of the above

Solution

Relevant Provision

Section 48:- The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :—

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto:

Considering the above provision, the time of incurring expenditure is not at all relevant for deciding the deductibility of the same.

Readers Note:

6.9 COST INFLATION INDEX CHART

The Central Government has notified the "Cost inflation index" for the purpose of long-term capital gain as follows:

Financial year	*Cost inflation index*	*Financial year*	*Cost inflation index*
2001-02	100	2010-11	167
2002-03	105	2011-12	184
2003-04	109	2012-13	200
2004-05	113	2013-14	220
2005-06	117	2014-15	240
2006-07	122	2015-16	254
2007-08	129	2016-17	264
2008-09	137	2017-18	272
2009-10	148		

Practical 4

Mr. X purchased a property on **April 1, 1999** for Rs. 1,05,000. He entered into agreement for sale of the property to A on **November 1, 2005** and received Rs. 25,000 as advance. A could not, however, keep his promise and the advance of Rs. 25,000 given by him was forfeited by X. Later on he gifted the property to his friend Mr. Y on **May 15, 2007.** The following expenses were incurred by X and Y for renewals of the property:

Particulars	**Cost (in Rs.)**
Addition of two rooms by X during **2000-01**	10,000
Addition of first floor by X during **2006-07**	50,000
Addition of second floor by Y during **2013-14**	1,90,000

Fair market value of the property on **April 1, 2001** is Rs. 1,50,000. Y entered into an agreement to sell the property to Mr. B on **April 1, 2016** after receiving an advance of Rs. 80,000. Mr. B could not pay the balance within the stipulated time of two months and Mr. Y forfeited the advance of Rs. 80,000 as per agreement with Mr. B. Mr. Y ultimately found a buyer in Mr. C to whom property is transferred for Rs. 62,00,000 on **December 1, 2017.** Compute the capital gain.**[2011, May IPCC]**

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. Y

Period of Holding: 01.04.1999 to 01.12.2017
Nature of Capital Asset: Long Term

Particulars		**(Rs.)**
Full value of consideration		62,00,000
Less: Expenses in connection with Transfer		-
Net Consideration		62,00,000
Less: Indexed Cost of acquisition	$(1,50,000 - 80,000) \times \frac{272}{100}$	(1,90,400)
Less: Indexed Cost of improvement	$50,000 \times \frac{272}{122}$	(1,11,475)
Less: Indexed Cost of improvement	$1,90,000 \times \frac{272}{220}$	(2,34,909)
Long Term Capital Gain		**56,63,216**

Readers Note:

6.10 SPECIAL PROVISIONS FOR COMPUTING CAPITAL GAIN IN THE HANDS OF NON-RESIDENT - CONVERSION RULE AND BENEFIT OF INDEXATION

Section:- First and second proviso to section 48

(1) First Proviso to Section 48

First proviso to section 48 is applicable only in the case of a non-resident. Under this provision, capital gain is first calculated in foreign currency and then converted in to Indian currency.

(2) Conditions

1. The taxpayer is a non-resident (except the cases covered by sections 115AC and 115AD) at the time of sale of capital asset.
2. He acquires shares or debentures of an Indian company by utilizing foreign currency.

(3) Conversion Rules

Particulars	***Conservation rate***
1. Sale consideration	Average exchange rate **on date of transfer**
2. Cost of acquisition	Average exchange rate **on date of acquisition**
3. **Expenditure on sale**	**Average exchange rate on date of transfer**
4. Capital gain	**Buying rate on date of transfer**

(4) Benefit of indexation not available (second proviso to section 48)

Second proviso to section 48 provides that benefit of indexation is not available in respect of capital gain covered under first proviso to section 48.

Remark: Conversion Rule is mandatory (not optional) once conditions of first proviso to section 48 are satisfied.

Practical 5

Mr. Rackson, a non-resident foreign citizen, remits US $ 85,000 to India on **November 28, 2002**. The amount is partly utilised on **December 02, 2002** for purchasing 82,000 shares in Tech-Ex Pvt. Ltd., an Indian company, at the rate of Rs.42 per share. These shares are sold for Rs.79 per share on **July 25, 2017.** Brokerage expenses Rs.0.90 per share which was paid on **July 30, 2017.**

Find out the capital gains chargeable to tax on the assumption that telegraphic transfer, buying and selling rates of US dollars adopted by the State Bank of India are as follows:

Particulars	**Buying (1 US $) Rs.**	**Selling (1 US $) Rs.**
November 28, 2002	47.15	47.25
December 02, 2002	46.95	47.05
July 25, **2017**	60.65	62.15
July 30, **2017**	61.05	61.95

Solution

Particulars	Indian Currency (Rs.)	Conversion Rule	Foreign Currency ($)
Sale Consideration	64,78,000	Average Rate on Date of Transfer 1$ = Rs. 61.40	1,05,504.89
Less: Expenses	(73,800)	Average Rate on Date of Transfer 1$ = Rs. 61.40	(1,201.95)
Less: Cost of Acquisition	(34,44,000)	Average Rate on Date of Acquisition 1$ = Rs. 47	(73,276.60)
Long Term Capital Gain	**NA**		**31,026.34**

Long Term Capital Gain in Indian Currency = $ 31,026.34 x Buying Rate on the date of transfer
= $ 31,026.34 x Rs.60.65
= Rs.18,81,747.52

Readers Note:

UNIT B – DEEMED FULL VALUE OF CONSIDERATION

6.11 COMPUTATION OF CAPITAL GAIN WHEN INSURANCE COMPENSATION IS RECEIVED ON DESTRUCTION OF OR DAMAGE TO CAPITAL ASSET

Section:- 45(1A)

Supreme Court in case of Vania Silk Mills (P.) Ltd. held that insurance claim received on destruction of asset is not chargeable to capital gain tax as "destruction" of asset does not amount to transfer of capital asset.

However, the effect of the judgment has been partly nullified by Section 45(1A).

Section 45(1A) is applicable if following conditions are satisfied

Sr. No.	Conditions
1.	Any money or other assets are received from insurance co on account of 'damage to' or 'destruction of' any capital asset.
2.	The damage or destruction is as a result of (a) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or (b) riot or civil disturbance; or (c) accidental fire explosion; or (d) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war)

Tax consequences when above conditions are satisfied:

1. Any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains".
2. It shall be deemed to be the income of such person for the previous year in which such money or other asset is received.
3. For computing capital gain under section 48, the value of any money or the fair market value of other asset on the date of receipt shall be deemed to be the full value of the consideration received or accruing as a result of transfer of such asset.

Brainstorming: *Whether following capital receipts are chargeable to tax?*

Illustrations:

1. Receipt of insurance compensation on destruction of plant and machinery in a road accident.
2. Receipt of insurance claim on loss of ship being sunk due to overloading.

Practical 6

Mr. ZB purchased painting on 05.05.2016 for Rs. 1,00,000. This painting was prepared by famous artist M.F. Husain. On 28.03.2017, this painting got destroyed in accidental fire explosion. Insurance company awarded him a compensation of Rs. 1,15,000 for the same. However, such compensation was paid on 06.06.2017. Compute capital gain, if any, in the hands of Mr. ZB.

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. ZB

Period of Holding: 05.05.2016 to 28.03.2017 Nature of Capital Asset: Short Term	
Particulars	**(Rs.)**
Full value of consideration = Amount received from Insurance company	1,05,000
Less: Expenses in connection with Transfer	-
Net Consideration	1,05,000
Less: Cost of acquisition	1,00,000
Short Term Capital Gain	**5,000**

Readers Note:

BRAINSTORMING: DOES YOUR ANSWR DIFFER IF PAINTING WAS STOLEN?

6.12 COMPUTATION OF CAPITAL GAIN IN THE CASE OF CONVERSION OF CAPITAL ASSET INTO STOCK-IN-TRADE

Section:- 45(2)

1. With effect from the **assessment year 1985-86**, conversion of investment into stock-in-trade will be treated as transfer under section 2(*47*). It will be treated as "transfer" in the year in which capital asset is converted into stock-in-trade.
2. The notional profit arising from transfer by way of conversion of capital asset into stock-in-trade will be chargeable to tax in the year in which stock-in-trade is sold or otherwise transferred.
3. For the purpose of computing the capital gain in such case, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

Practical 7

Mr. Kalyan purchased jewelry for Rs. 3,00,000 on 10-05-2001. He then converted the same into stock-in- trade on 10-4-2004. The fair market value on date of conversion was Rs. 4,50,000. He then sold out such jewelry from stock-in trade for Rs. 10,50,000 on 10-05-2017. Discuss tax consequences in the hands of Mr. Kalyan.

Solution

1) Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. Kalyan

Period of Holding: 10.05.2001 to 10.04.2004 Nature of Capital Asset: Short Term	
Particulars	**Rs.**
Full value of consideration = FMV on the date of conversion	4,50,000
Less: Expenses in connection with Transfer	-
Net Consideration	4,50,000
Less: Cost of acquisition	3,00,000
Short Term Capital Gain	**1,50,000**

2) Computation of Business Profit for the Previous Year 2017-18 in the hands of Mr. Kalyan.

Particulars	Rs.
Sale of jewelry	10,50,000
Less: Fair Market Value of jewelry on the date of conversion of jewelry into stock in trade	(4,50,000)
Business Profits chargeable to tax	6,00,000

Readers Note:

Practical 8

Suppose in the above problem, Mr. Kalyan converted jewelry on 10-04-2005 and fair market value on that date was Rs. 4,75,000. Discuss tax consequences.

Solution

1) Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. Kalyan

Period of Holding: 10.05.2001 to 10.04.2005
Nature of Capital Asset: Long Term

Particulars		Rs.
Full value of consideration = FMV on date of conversion		4,75,000
Less: Expenses in connection with Transfer		-
Net Consideration		4,75,000
Less: Indexed Cost of acquisition	$3{,}00{,}000 \times \frac{117}{100}$	(3,51,000)
Long Term Capital Gain		**1,24,000**

2) Computation of Business Profit for the Previous Year 2017-17 in the hands of Mr. Kalyan.

Particulars	Rs.
Sale value of jewelry	10,50,000
Less: Fair Market Value of jewelry on the date of conversion of jewelry into stock in trade	(4,75,000)
Business Profits chargeable to tax	5,75,000

Readers Note:

6.13 COMPUTATION OF CAPITAL GAIN IN THE CASE OF TRANSFER OF CAPITAL ASSET BY A PARTNER TO A FIRM AS CAPITAL CONTRIBUTION OR OTHERWISE

Section:- 45(3)

Section 45(3) is applicable if following conditions are satisfied

Sr. No.	*Conditions*
1.	A person is a partner in a firm or he becomes a partner in a firm.
2.	He transfers a capital asset to the firm by way of capital contribution or otherwise.

Tax consequences when above conditions are satisfied:

a. Partner is chargeable to capital gain tax in the previous year in which such transfer takes place ;
b. For computing capital gain under section 48**, the amount recorded in the books of account of the firm** shall be deemed to be the full value of consideration received as a result of transfer.

Practical 9

Mr. X joined a firm of two partners A and B (named AB & Co.) by transferring a capital asset to the firm on **15-05-2017** whose market value is Rs. 10 lakh. However, in the books of the firm, it was recorded at Rs. 8 lakh only. Compute capital gain in the hands of Mr. X assuming that indexed cost of such asset was Rs. 3.5 lakh.

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. X

Particulars	(Rs.)
Full value of consideration = Amount recorded in books	8,00,000
Less: Expenses in connection with Transfer	-
Net Consideration	8,00,000
Less: Indexed Cost of acquisition	(3,50,000)
Long Term Capital Gain	**4,50,000**

Readers Note:

6.14 COMPUTATION OF CAPITAL GAIN IN THE CASE OF TRANSFER OF CAPITAL ASSET BY A FIRM TO PARTNER ON DISSOLUTION OR OTHERWISE.

Section:- 45(4)

Section 45(4) is applicable if following conditions are satisfied

Sr. No.	*Conditions*
1.	Firm transfers capital asset to the partner.
2.	Such transfer is by way of distribution of capital assets on the dissolution of firm or otherwise.

Tax consequences when above conditions are satisfied:

a. Firm is chargeable to capital gain tax in the previous year in which such transfer takes place ;
b. For computing capital gain under section 48**, fair market value of asset on the date of transfer** shall be deemed to be the full value of consideration received as a result of transfer.

Practical 10

Ram and Shyam are two partners of a firm R & S Co. since 1975. On **Feb 28, 2018**, the firm was dissolved. The following assets were distributed to partners:

	Residential house (taken over by Ram) Rs.	**Silver (taken over by Shyam) Rs.**
Fair market value on **Feb 28, 2018**	45,00,000	1,00,000
Agreed value as per dissolution deed	25,00,000	1,50,000
Year of acquisition	1995-96	2008-09
Cost of acquisition	1,70,000	10,000
Fair market value on April 1, 2001	2,50,000	N.A.

Determine the amount of chargeable capital gains of the firm.

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of a firm

- Capital Asset - Residential House

Period of Holding: 1995-96 to **28.02.2018**
Nature of Capital Asset: Long Term

Particulars		**(Rs.)**
Full value of consideration		45,00,000
Less: Expenses in connection with Transfer		-
Net Consideration		45,00,000
Less: Indexed Cost of acquisition	$2,50,000 \times \frac{272}{100}$	6,80,000
Long Term Capital Gain		**38,20,000**

- Capital Asset – Silver

Period of Holding: 2008-09 to **28.02.2018**
Nature of Capital Asset: Long Term

Particulars		**(Rs.)**
Full value of consideration		1,00,000
Less: Expenses in connection with Transfer		-
Net Consideration		1,00,000
Less: Indexed Cost of acquisition	$10,000 \times \frac{272}{137}$	(19,854)
Long Term Capital Gain		**80,146**

Readers Note:

6.15 COMPUTATION OF CAPITAL GAIN IN THE CASE OF TRANSFER OF CAPITAL ASSET UNDER COMPULSORY ACQUISITION.

Section:- 45(5)

When section 45(5) is applicable- In any of the following cases, section 45(5) is applicable —

1. When the transfer of a capital asset is by way of compulsory acquisition under any law.
2. When a capital asset is transferred not by way of compulsory acquisition but the consideration is approved or determined by the Central Government or the Reserve Bank of India.

Section 45(5)(a):- *Tax Treatment of initial compensation–*

Initial compensation is chargeable to tax in the previous year in which such compensation (or part thereof) is first received.

Further, for computing capital gain, initial compensation shall be taken as full value of consideration.

Practical 11

The Central Government acquires a house property owned by Mr. Manish on October 17, 2005 fixing compensation at Rs. 32,00,000. The indexed cost of acquisition of this house property is Rs. 28,00,000. The Government paid Rs. 20,00,000 partly on May 13, 2010 and balance on March 11, 2012. Compute capital gain in the hands of Mr. Manish.

Solution

Computation of Capital Gain for the Previous Year 2010-11 in the hands of Mr. Manish

Indexed cost of acquisition is given in the question, therefore,
Nature of Capital Asset: Long Term

Particulars	(Rs.)
Full value of consideration = Initial compensation	32,00,000
Less: Expenses in connection with Transfer	-
Net Consideration	32,00,000
Less: Indexed Cost of acquisition	28,00,000
Long Term Capital Gain	**4,00,000**

Readers Note:

Section 45(5)(b):-*Tax Treatment of enhanced compensation* **-** If any compensation is enhanced by a court, tribunal or any authority, then tax treatment shall be as under—

1. It shall be taxable in the previous year in which enhanced compensation is received by the assessee. **Exception:** If enhanced compensation is received due to interim order of court then same shall be taxed in the year in which the court passes final order.
2. Cost of acquisition and the cost of improvement shall be taken as *nil*.
3. Litigation expenses for getting the compensation enhanced are deductible as an expense in connection with transfer.
4. Enhanced compensation can be short-term capital or long-term capital depending upon the nature of original capital gain.

Practical 12

In continuation of above problem, being aggrieved against the award, Mr. Manish filed an appeal. The High Court, by an interim order dated **July 19, 2016** ordered Central Government to pay Rs. 5,00,000 which was paid on **15th July, 2017**. However, High Court passed final order dated **11th August, 2017** fixing enhanced compensation of Rs. 17,00,000. The Central Government paid 12,00,000 (Rs. 5,00,000 has already been paid) on **12th December, 2017**. Legal expenses incurred by Mr. Manish for High Court matter were Rs.45,000. Compute the income of Mr. Manish under the head "Capital gains".

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. Manish

		Previous Year: 2017-18 **Assessment Year: 2018-19**
	Particulars	**Rs.**
	Enhanced Compensation due to interim order of court [Note (i)]	5,00,000
	Balance Enhanced Compensation due to final order of court [Note (ii)]	12,00,000
Less:	Expenses on transfer	(45,000)
Less:	Indexed cost of acquisition / Cost of Improvement	Nil
	Long Term Capital Gain	**16,55,000**

Readers Note:

NOTE:

(i) Though enhanced compensation of Rs. 5,00,000 has been received due to an interim order of a court during previous year 2016-17, same shall be taxed in the previous year in which the final order of court is made. (In this example, final order is made on 11th August, 2017 therefore, this Rs. 5,00,000 shall be taxed in the previous year 2017-18)

(ii) As per section 45(5)(b), Enhanced Compensation Rs. 12,00,000 shall be taxed in the year of receipt. (In this example, Rs.12,00,000 has been received on 12th December, 2017 therefore, it shall also be taxed in the previous year 2017-18)

Section 45(5)(c):-*Tax Treatment of enhanced compensation which got subsequently reduced because of order of Court, Tribunal or other authority*

1. Where amount of enhanced compensation is subsequently reduced by any court, Tribunal or other authority, the capital gain of that year (the year in which enhanced compensation was taxed), shall be recomputed by replacing revised enhanced compensation.
2. Any further litigation expenses incurred shall be deductible as an expense.

Practical 13

In continuation of above problem, being aggrieved against the enhanced compensation fixed by High Court, Central Government preferred an appeal to Supreme Court. Supreme Court by its order dated **10th October, 2020** fixed enhanced compensation at Rs. 15,00,000 as against Rs.17,00,000 fixed by High Court. Legal expenses incurred by Mr. Manish for Supreme Court matter were Rs.50,000. Discuss tax consequences of such reduction in enhanced compensation.

Solution

Re-Computation of Capital Gain because of reduction of enhanced compensation

		Previous Year: 2017-18 Assessment Year: 2018-19
	Particulars	**Rs.**
	Revised Enhanced Compensation due to final order of Supreme Court	15,00,000
Less:	Expenses in connection with transfer (High Court litigation exps)	(45,000)
Less:	Expenses in connection with transfer (Supreme Court Litigation exps)	(50,000)
Less:	Indexed cost of acquisition / Cost of Improvement	Nil
	Recomputed Long Term Capital Gain	**14,05,000**

Readers Note:

6.16 SPECIAL PROVISIONS FOR COMPUTATION OF CAPITAL GAIN IN CASE OF JOINT DEVELOPMENT AGREEMENT

Section:- 45(5A) and 49(7) - Effective from A.Y.2018-19

Section 45(5A):- Taxability of capital gains in case of Specified agreement:

The definition of 'transfer', inter alia, includes any arrangement or transaction where any rights are handed over in execution of part performance of contract, even though the legal title has not been transferred.

And therefore, execution of Joint Development Agreement between the owner of immovable property and the developer attracts capital gain tax liability in the hands of owner in the year in which possession is handed over to the developer.

With a view to minimise the genuine hardship which the owner of land or building may face in paying capital gains tax in the year of transfer, a new sub-section (5A) in section 45 has been inserted to provide that

- in case of an assessee being individual or Hindu undivided family who transfers land or building or both under a specified agreement,
- then capital gain arising from such transfer shall be chargeable to income-tax as income of the **previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority.**

What is the full value of consideration? The stamp duty value of his share, being land or building or both, in the project on the date of issuing of said certificate of completion as increased by any consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

Benefit of provisions of section 45(5A) not available [Proviso to section 45(5A)]:- It may, however, be noted these beneficial provisions would not apply, where the assessee transfers his share in the project on or before the date of issue of said completion certificate and therefore, the capital gain tax liability would be deemed to arise in the previous year in which such transfer took place. In such a case, full value of consideration received or accruing shall be determined by the general provisions of the Act.

Meaning of certain terms:

(a) Specified Agreement:- Specified agreement means the registered agreement in which a person owing land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash.

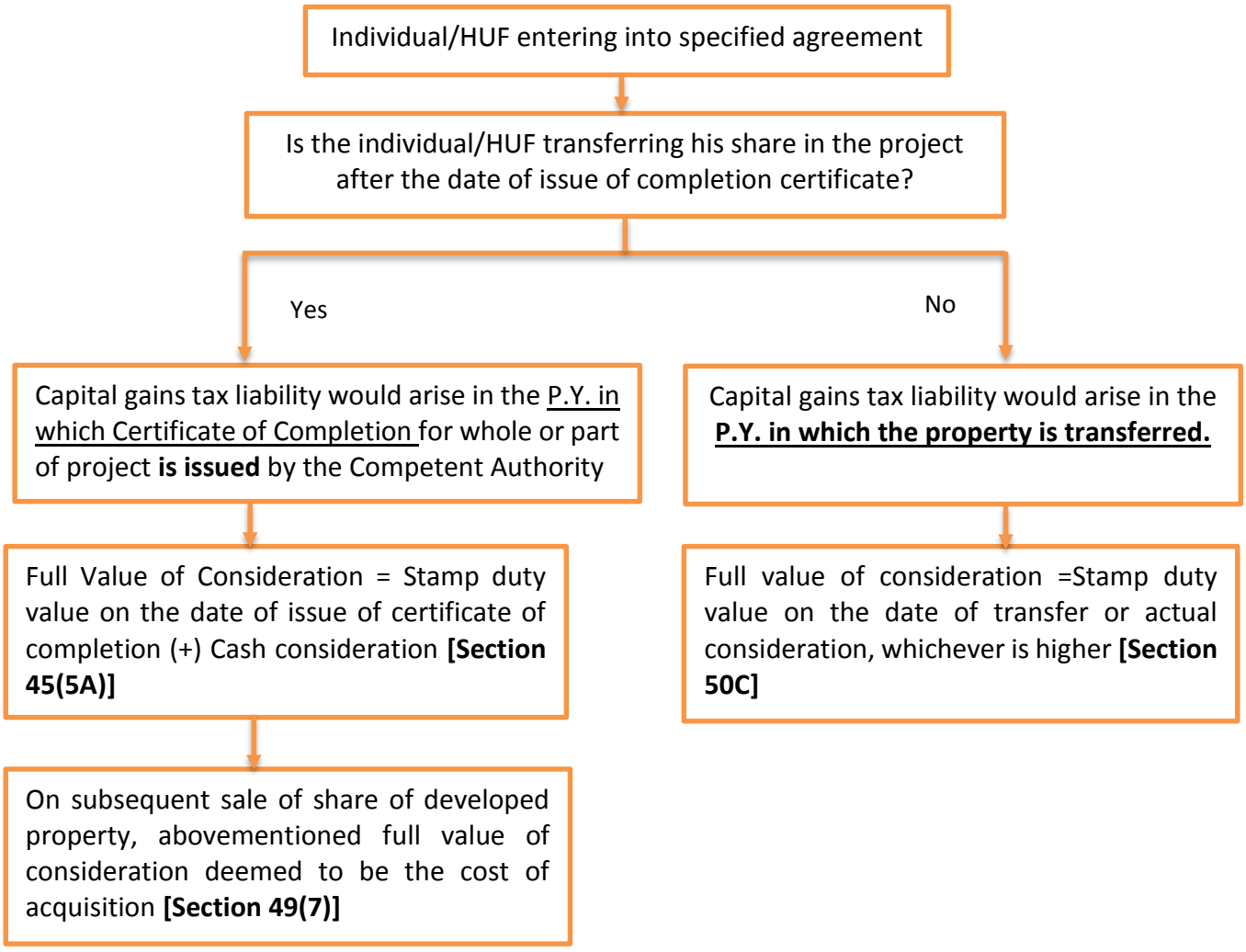
(b) Competent authority:- The authority empowered to approve the building plan by or under any law for the time being in force.

(c) Stamp duty value:- The value adopted or assessed or reassessable by any authority of Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.

Section 49(7):- Cost of acquisition of capital asset, being share in the project referred under section 45(5A)

Where the capital gain arises from the transfer of a capital asset, being share in the project, in the form of land or building or both, referred to in section 45(5A) which is chargeable to tax in the previous year in which the completion of certificate for the whole or part of the project is issued by the competent authority), the cost of acquisition of such asset, shall be the amount which is deemed as full value of consideration in that sub-section.

SUMMARY



Practical 14

Mr. Abhinav provides following information:

(a) He purchased small plot of land in Ahmedabad on 10th July 1998 for Rs. 10 lakh (fair market value of such plot as on 1st April, 2001 was Rs. 12 lakh)

(b) He entered into a "Specified Agreement" with Amrapali Devlopers Ltd. on 18th May 2017.

(c) Agreed consideration was : Cash component Rs. 1 Crore and 50% share in constructed area

(d) Project completion certificate was issued by Local authority on 10th August, 2018.

(e) Stamp duty valuation of 50% share in constructed area (as on 10th August, 2018): Rs. 2.25 Crore.

(f) He sold out the constructed area allotted to him on 1st May, 2019 for Rs. 3 Cr.

Discuss tax consequences of above transaction in the hands of Mr. Abhinav

Solution

Computation of Long Term Capital Gain in the hands of Abhinav for P.Y. 2018-19

Period of Holding: From 10-07-1998 to 18-05-2017
Type of Capital Asset : Long Term

Particulars	Rs.
Full value of consideration (Rs. 1 Cr. + Rs. 2.25 Cr.)	3,25,00,000
Less: Expenses in connection with Transfer	Nil
Net Consideration	3,25,00,000
Less: Indexed Cost of Acquisition $(\text{Rs. } 12{,}00{,}000) \times \frac{272}{100}$	32,64,000
Taxable Long Term Capital Gain	**2,92,36,000**

Computation of Long Term Capital Gain in the hands of Abhinav P.Y. 2019-20

Period of Holding: From 10-08-2018 to 01-05-2019
Type of Capital Asset : Short Term

Particulars	Rs.
Full value of consideration	3,00,00,000
Less: Expenses in connection with Transfer	Nil
Net Consideration	3,00,00,000
Less: Cost of Acquisition **as per section 49(7)**	2,25,00,000
Taxable Short Term Capital Gain	**75,00,000**

Reader's Note:

6.17 CAPITAL GAINS ON DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION

Section:- 46

(a) In the hands of liquidated company

As per the provisions of section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer.

However, such distribution on liquidation to the shareholders amounts to deemed dividend under section 2(22)(c), to the extent company possesses accumulated profits. On such deemed dividend, company is required to pay CDT under section 115-O of the Act.

(b) In the hands of shareholders

On receipt of such distribution, shareholders are liable to pay capital gain tax since they extinguished their rights as shareholders. For computing capital gain in the hands of shareholder, section 46(2) of the Act provides that:

Full Value of consideration = Money Plus FMV of assets received on distribution (-) deemed dividend.

(c) Capital gains tax on subsequent sale by the shareholders of assets so received on liquidation

As per section 55(2)(b)(iii), the cost of acquisition such asset shall be the fair market value of asset on the date of distribution.

Practical 15

Aries Tubes Private Ltd. went into liquidation on 01.06.2017. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

Particulars	Rs.
Share Capital (issued on 01.04.2012)	5,00,000
Reserves prior to 1.6.2017	3,00,000
Excess realization in the course of liquidation	5,00,000
	13,00,000

There are 5 shareholders, each of whom received Rs. 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income tax.

Solution

In this case, the accumulated profits immediately before liquidation is Rs. 3,00,000. The share of each shareholder is Rs. 60,000 (being one-fifth of Rs. 3,00,000). An amount of Rs. 60,000 is the deemed dividend under section 2(22)(c). The same is exempt under section 10(34) in the hands of the shareholder, since the company is liable to dividend distribution tax in respect of the same.

Therefore, Rs. 2,00,000 [i.e. Rs. 2,60,000 minus Rs. 60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2).

Against this, the investment of Rs. 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of Rs. 1,00,000 of each shareholder. The benefit of indexation is available to the shareholders (since the shares are held for more than 24 months and hence long-term capital asset), but could not be computed in the absence of required information.

As per section 112 of the Act, Such capital gain would be taxable @ 20%.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj). Therefore, exemption under section 54EC will not be available in this case since it is deemed transfer and not actual transfer.

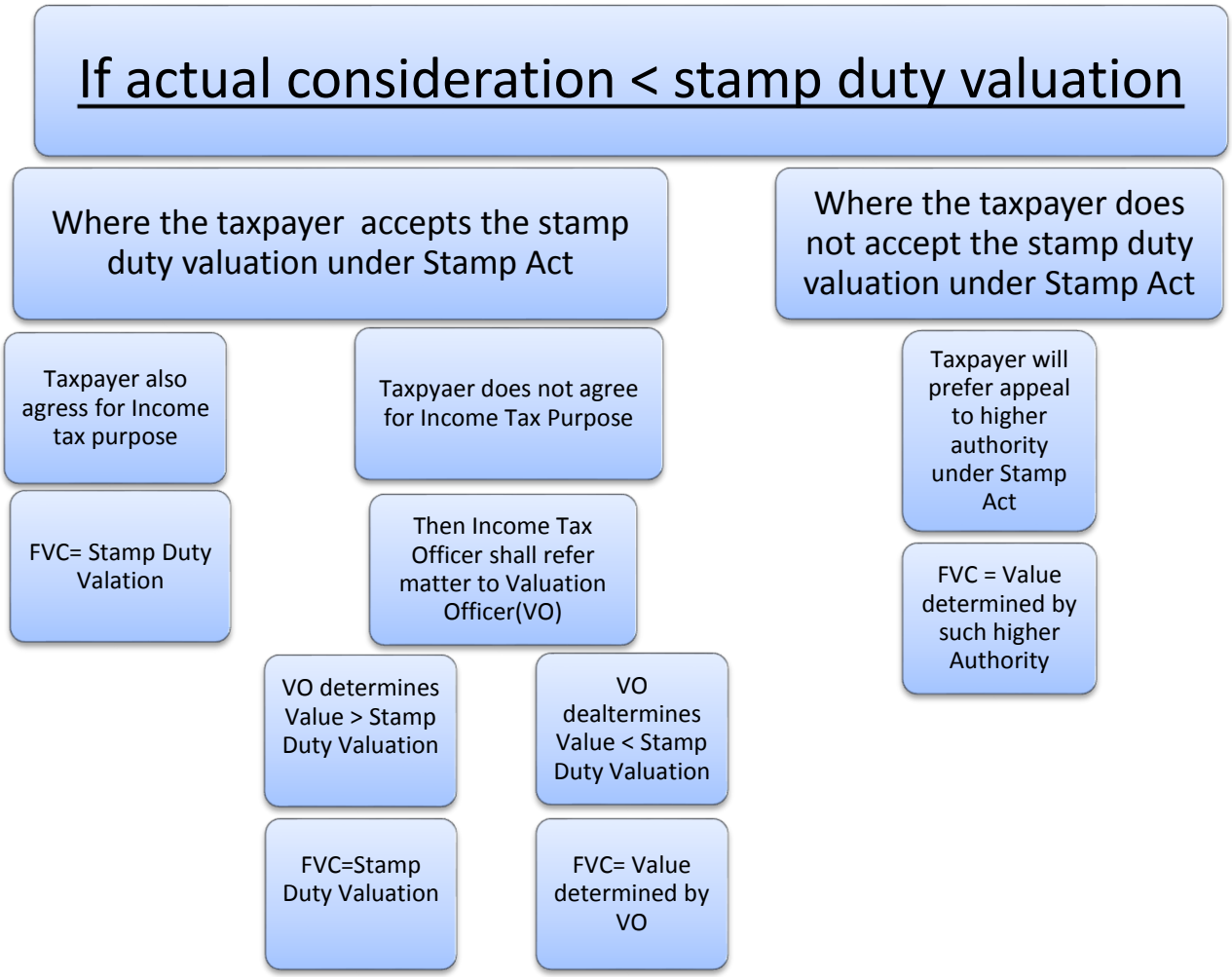
Note: However, in case a view is taken that on liquidation of a company, the shareholders right in the said company is extinguished, then, this transaction shall be regarded as transfer as per section 2(47) and therefore, exemption under section 54EC can be claimed by the shareholder.

Readers Note:

6.18 FULL VALUE OF CONSIDERATION IN CASE OF REAL ESTATE TRANSACTIONS

Section:- 5OC

This section is applicable when consideration received on transfer of land or building or both is less than the value adopted by Stamp Authority for the purpose of payment of stamp duty. Consider the following situations:-



As per first and second proviso to section 50 C(1) as inserted by Finance Act, 2016, if there is a time gap between the date of the agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration.

However, for the same, at least a part of the consideration has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of the agreement.

Practical 16

Bala sold his vacant site on **30.09.2017** for Rs. 7,00,000 . It was acquired by him on 1.10.2003 for Rs. 1,50,000. The state stamp valuation authority fixed the value of the site at the time of transfer @ Rs. 13,00,000. Compute capital gains in the hands of Bala and give your reasons for computation.
[2004, May PE II]

Solution

Computation of Capital Gain for the Previous Year 2017-186 in the hands of a Mr.Bala

Period of Holding : 01.10.2003 to 30.09.**2017** Nature of Capital Asset: Long Term	
Particulars	**(Rs.)**
Full value of consideration under section 50 C	13,00,000
Less: Expenses in connection with Transfer	-
Net Consideration	13,00,000
Less: Indexed Cost of acquisition $1,50,000 \times \frac{272}{109}$	(3,74,311)
Long Term Capital Gain	**9,25,689**

Readers Note:

Practical 17

Mr. Raj kumar had purchased the land on **1st June 2013** for Rs. 5,19,000 and completed the construction of house on **1st October, 2016** for Rs. 14,00,000. He sold this house to his friend Mr. Dhruv on **1st November, 2017** for a consideration of Rs. 35,00,000. The sub-registrar refused to register the document for the said value, as according to him, stamp duty had to be paid on Rs. 65,00,000, which was the government guideline value. Mr. Rajkumar preferred an appeal to the Revenue Divisional Officer under Stamp Act, who fixed the value of the house at Rs. 44,00,000 (Rs.29,00,000 for land and the balance for building portion). The differential stamp duty was paid, accepting the said value determined. Compute capital gain in the hands of Raj Kumar. **[IPCC-May 2010]**

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of a Mr. Rajkumar

- **Capital Asset: Land**

Period of Holding : 01.06.2013 to 01.11.2017 Nature of Capital Asset: Long Term	
Particulars	**(Rs.)**
Full value of consideration as per Section 50 C	29,00,000
Less: Expenses in connection with Transfer	-
Net Consideration	29,00,000
Less: Indexed Cost of acquisition (Land) $5,19,000 \times \frac{272}{220}$	(6,14,672)
Long Term Capital Gain	**22,85,328**

- **Capital Asset: Building**

Period of Holding : 01.10.2016 to 01.11.2017 Nature of Capital Asset: Short Term	
Particulars	**(Rs.)**
Full value of consideration as per Section 50 C	15,00,000
Less: Expenses in connection with Transfer	-
Net Consideration	15,00,000
Less: Cost of acquisition (Building)	(14,00,00)
Short Term Capital Gain	**1,00,000**

Readers Note:

Practical 18

Mr. Thomas inherited a house in Jaipur under will of his father in **May, 2010**. The house was purchased by his father in **January, 2000** for Rs. 2,50,000. He invested an amount of Rs. 7,00,000 in construction of one more floor in this house in **June, 2013**. The house was sold by him in **November, 2017** for Rs. 37,50,000. The valuation adopted by the registration authorities for charge of stamp duty was Rs. 47,25,000 which was not contested by the buyer, but as per assessee's request, the Assessing Officer made a reference to Valuation Officer. The value determined by the Valuation Officer was Rs. 47,50,000. Brokerage @ 1% of sale consideration was paid by Mr. Thomas to Mr. Sunil. The market value of house as on 01.04.2001 was Rs. 2,70,000. You are required to compute the amount of capital gain chargeable to tax for Previous Year **2017-18** with help of given information.

[PCC-Nov 2007]

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of a Mr. Thomas

Period of Holding: January 2000 to November 2017
Nature of Capital Asset: Long Term

Particulars		Rs.
Full value of consideration as per section 50C		47,25,000
Less: Expenses in connection with Transfer		(37,500)
Net Consideration		46,87,500
Less: Indexed Cost of acquisition	$2{,}70{,}000 \times \frac{272}{100}$	(7,34,400)
Less: Indexed Cost of improvement	$7{,}00{,}000 \times \frac{272}{220}$	(8,65,454)
Long Term Capital Gain		**30,87,646**

Readers Note:

Practical 19

Suppose, in the above problem, valuation officer determines value under the stamp act at Rs. 47,00,000. What would be the amount of capital gain chargeable to tax?

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of a Mr. Thomas

Period of Holding: January 2001 to November 2017
Nature of Capital Asset: Long Term

Particulars		Rs.
Full value of consideration as per section 50C		47,00,000
Less: Expenses in connection with Transfer		37,500
Net Consideration		46,62,500
Less: Indexed Cost of acquisition	$2{,}70{,}000 \times \frac{272}{100}$	(7,34,400)
Less: Indexed Cost of improvement	$7{,}00{,}000 \times \frac{272}{220}$	(8,65,454)
Long Term Capital Gain		**30,62,646**

Readers Note:

6.19 FAIR MARKET VALUE TO BE THE FULL VALUE OF CONSIDERATION FOR TRANSFER OF UNQUOTED SHARES - Effective from A.Y.2018-19

Section:- 50CA

In order to ensure the full consideration is not understated in case of transfer of unlisted shares, a new section 50CA has been inserted to provide that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

For the purpose, "quoted shares" means the share quoted on any recognized stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

Note:

The fair market value of the unquoted shares would be determined in the manner provided in sub-clause (b) or sub-clause (c), as the case may be, of Rule 11UA(1)(c) and for this purpose the reference to valuation date in the Rule 11U and 11UA shall mean the date on which the capital asset, being unquoted share of a company is transferred (Rule 11UAA).

For determination of fair market value: Refer Rule 11U and Rule 11UA under **Chapter 7: Income from Other Sources.**

Practical 20

Mr. Dravid provides following information:

(a) He subscribed shares of ABC Infrastructure Private Limited for Rs. 12,00,000 on 16th May, 2001.

(b) He sold out these shares for Rs. 85,00,000 on 18th May, 2017.

(c) Fair market value of this share on 18th May, 2017 was Rs. 98,00,000.

Discuss tax consequences of above transaction in the hands of Mr. Dravid.

Solution

Computation of Long Term Capital Gain in the hands of Mr. Dravid for P.Y.2017-18

Period of Holding: From 16-05-2001 to 18-05-2017
Type of Capital Asset : Long Term

Particulars		Rs.
Full value of consideration (actual consideration or FMV whichever is higher		98,00,000
Less: Expenses in connection with Transfer		Nil
Net Consideration		98,00,000
Less: Indexed Cost of Acquisition	$(\text{Rs. } 12,00,000) \times \frac{272}{100}$	32,64,000
Taxable Long Term Capital Gain		**65,36,000**

Reader's Note:

6.20 HOW TO COMPUTE CAPITAL GAINS IF FULL VALUE OF CONSIDERATION OF CAPITAL ASSET CANNOT BE ASCERTAINED?

Section:- 50D

Section 50D has been inserted from A.Y. 2013-14 which provides that where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.".

Practical 21

Mr. A obtained Gold Loan from HDFC Bank Ltd. Mr. A could not pay this loan together with accrued interest amounting to Rs. 13,00,000. As a result, HDFC Bank made full and final settlement against gold ornaments. Compute capital gain, if any, in the hands of Mr. A based on following information:

1. Date of purchase of Gold ornaments: **10th April, 2001**
2. Gold ornaments purchased for : Rs. 60,000.
3. Date of settlement with HDFC Bank: **10-05-2017**
4. Fair market value on date of Settlement : Rs. 11,95,000

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. A

Period of Holding: 10.04.2001 to 10-05-2017
Nature of Capital Asset: Long Term

Particulars		(Rs.)
Full value of consideration = FMV on date of settlement		11,95,000
Less: Expenses in connection with Transfer		-
Net Consideration		11,95,000
Less: Indexed Cost of acquisition	$60{,}000 \times \frac{272}{100}$	(1,63,200)
Long Term Capital Gain		**10,31,800**

Readers Note:

UNIT C – DEEMED COST OF ACQUISITION

6.21 TAXABILITY OF SELF GENERATED ASSETS

Section:- 55

Supreme Court in case of CIT v. B.C. Srinivasa Shetty (1981) 5 Taxman 1, held that if cost of acquisition of capital asset cannot be ascertained then capital gain cannot be measured and therefore, transfer of such capital asset is not subject to capital gain tax.

However, by virtue of the provisions of section 55, while calculating capital gain on transfer of the following self-generated assets, cost of acquisition and cost of improvement shall be taken as under:

Self-generated assets		What shall be the cost of acquisition?	What shall be cost of improvement?
1.	Goodwill of a business or profession	Nil	Nil
2.	Tenancy rights, route permits and loom hours	Nil	Actual
3.	Right to manufacture, produce or process any article or right to carry on any business or profession	Nil	Nil
4.	Trade mark or brand name associated with a business	Nil	Actual

(a) The rule mentioned in above table is applicable only in the case of "self-generated assets". If an asset is purchased and later on sold, then the actual purchase price shall be taken as cost of acquisition

(b) If above assets were acquired before April 1, 2001, the option of adopting the fair market value on the said date is not available.

6.22 COST OF ACQUISTION OF BONUS SHARES

Section:- 55

Particulars	Cost of acquisition bonus shares
If bonus shares are allotted after April 1, 2001	Cost of acquisition shall be taken as Nil
If bonus shares are acquired before April 1, 2001	Cost of acquisition (Nil) or Fair market value on April 1, 2001 whichever is higher. But obvious, Fair market value on April 1, 2001 is higher, therefore FMV as on April 1, 2001 shall be taken as cost of acquisition.

Practical 22

Ayush purchased 1,000 equity shares in Kalyani offset Ltd. for Rs. 10,000 on May 12, 1990. He received 500 bonus shares on June 25, 2000. He further received 750 bonus shares on **25th August, 2016**.
On **June 25, 2017**, Ayush transferred all the shares for Rs.1400 per share. Fair market value of shares of Kalyani offset Ltd. on **April 1, 2001** is Rs. 100 per share.
Compute capital gain assuming that shares of Kalyani Offset Ltd. are not listed.

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of a Mr. Ayush

- Capital Asset - Original Shares [1000 Shares]

Period of Holding: 12.05.1990 to 25.**06.2017** Nature of Capital Asset: Long Term		
Particulars		**(Rs.)**
Full value of consideration	[1,000 x 1400]	14,00,000
Less: Expenses in connection with Transfer		-
Net Consideration		14,00,000
Less: Indexed Cost of acquisition	$(1000 \times 100) \times \frac{272}{100}$	(2,72,000)
Long Term Capital Gain		**11,28,000**

- Capital Asset - Bonus shares [500 shares received before 01.04.2001]

Period of Holding: 25.06.2000 to 25.06.**2017** Nature of Capital Asset: Long Term		
Particulars		**(Rs.)**
Full value of consideration	[500 x 1400]	7,00,000
Less: Expenses in connection with Transfer		-
Net Consideration		7,00,000
Less: Indexed Cost of acquisition	$(500 \times 100) \times \frac{272}{100}$	(1,36,000)
Long Term Capital Gain		**5,64,000**

- Capital Asset - Bonus shares [750 shares received after 01.04.2001]

Period of Holding: 25.08.2016 to 25.06.**2017** Nature of Capital Asset: Short Term		
Particulars		**(Rs.)**
Full value of consideration	[750 x 1400]	10,50,000
Less: Expenses in connection with Transfer		-
Net Consideration		10,50,000
Less: Cost of acquisition		Nil
Short Term Capital Gain		**10,50,000**

Readers Note:

6.23 COST OF ACQUISTION IN CASE OF RIGHT SHARES

Section:- 55

Sr. No.	Different situations	Cost of Acquisition
(1)	If rights entitlement letter which is renounced by the assessee in favour of a third person, then cost of acquisition in the hands of assessee shall be	Nil

(2)	If rights shares are acquired by the taxpayer by exercising his right, then cost of acquisition shall be	the amount paid to the company for subscription of such shares.
(3)	If Rights shares purchased by the third person in whose favour the rights entitlement has been renounced, then cost of acquisition shall be	the amount paid to obtain the rights entitlement letter plus amount paid to the company for subscription of such shares.

Practical 23

Mr. A is a shareholder of X Company Ltd. holding 1,000 shares of face value of Rs. 10 each, allotted at the time of the company's incorporation in May, 2001. The company made a right issue in the ratio of 1:1 on **15.07.2017** at a premium of Rs. 40 per share. Instead of taking up the right, he renounced it in favour of Mr. B at a price of Rs. 10 per share. What is the capital gain chargeable in the hands of Mr. A? What will be the cost of shares in the hands of Mr. B?

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of a Mr. A

- Capital Asset - Renouncement of Rights offer letter

Nature of Capital Asset: Always Short Term		
Particulars		**(Rs.)**
Full value of consideration	[1,000 x 10]	10,000
Less: Expenses in connection with Transfer		-
Net Consideration		10,000
Less: Cost of acquisition		Nil
Short Term Capital Gain		**10,000**

Computation of Cost of Acquisition in the hands of a Mr. B

Particulars		**(Rs.)**
Cost paid to Mr. A	[1,000 x 10]	10,000
Add: Cost paid to the company	[1,000 x 50]	50,000
Total Cost of 1000 shares in the hands of Mr.B		60,000

Readers Note:

6.24 HOW TO FIND OUT CAPITAL GAINS WHEN EQUITY SHARES RECEIVED ON CONVERSION ARE SUBSEQUENTLY SOLD?

Section:- 49(2AE), Explanation to section 2(42A) - Effective from A.Y.2018-19

(a) Section 49(2AE) has been inserted to provide that cost of acquisition of preference shares shall be treated as cost of acquisition for equity shares (received on conversion).

(b) Further, to find out whether such equity shares received on conversion are long-term capital assets or not, the period of holding shall be determined from date of acquisition of preference shares of such company.– **Explanation 1 to section 2(42A).**

(c) The benefit of indexation will start from the date of acquisition of preference shares in the company.

Practical 24

Ms. Mayuri subscribed 10,000 preference shares of Online Education Private Limited @ Rs. 10 each on 18th August, 2015. Such shares were converted into 12,500 equity shares on 10th April, 2017. She then transferred 8,000 shares on 21st September, 2017 for Rs. 12 per share. Discuss tax consequences of above transaction in the hands of Ms. Mayuri.

Solution

As discussed earlier, conversion of preference shares into equity shares is not treated as transfer by virtue of section 47 (xb). Therefore, conversion will not attract capital gain tax liability in the hands of Ms. Mayuri.

Computation of Capital Gain in the hands of Ms. Mayuri.

Period of Holding: From 18-08-2015 to 21-09-2017 Type of Capital Asset : Long Term	
Particulars	**Rs.**
Full value of consideration (8,000 X Rs. 12)	96,000
Less: Expenses in connection with Transfer	Nil
Net Consideration	96,000
Less: Indexed Cost of Acquisition (Working Note)	(68,535)
Taxable Long Term Capital Gain	**27,465**

Working Note:-

Total Cost of 12500 equity shares	= Cost of preference shares =10000 × Rs. 10 = Rs.1,00,000
Hence, cost per equity share	= $\frac{1,00,000}{12500}$ = Rs.8
Hence, cost of acquisition of 8000 equity shares	=8000×Rs.8=Rs.64,000
Therefore, Indexed Cost of Acquisition =	=$\left(64000 \times \frac{272}{254}\right)$ =Rs.68,535

Readers Note:

6.25 HOW TO FIND OUT CAPITAL GAINS WHEN UNITS OF CONOSLIDATED PLAN ARE SUBSEQUENTLY SOLD?

Section:- 49(2AF), Explanation to section 2(42A) – w.r.e.f A.Y.2017-18

By virtue of section 47(xix), any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating plan of a mutual fund scheme, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated plan of that scheme of the mutual fund, is not treated as transfer.

(a) As **per section 49(2AF)**, the cost of acquisition of units allotted in consolidated plan of a Mutual Fund scheme shall be the cost of acquisition of the units in the consolidating plan of the scheme of Mutual fund.

(b) To find out whether units of consolidated plan are long-term capital assets or not, the period of holding shall be determined from date of acquisition of units in the consolidating plan of the scheme of mutual fund.– **Explanation 1 to Section 2(42A)**

(c) The benefit of indexation will start from the date of allotment / acquisition of units in the consolidating plan of the scheme of mutual fund.

Practical 1

ABC Mutual Funds operates various plans within a DEBT Scheme like ABC Debt Growth Fund, ABC Fixed Income Fund, ABC Dividend Income Fund. It has decided to consolidate all these plans into ABC Premier Debt Fund in accordance with guidelines of SEBI (Mutual Funds) Regulations, 1996 with effect from 10-07-16. Mr. Abhishek subscribed 10,000 units of ABC Debt Growth Fund on 10-08-2015 for Rs. 10 per unit. As a result of consolidation, he was allotted 13,333.33 units of ABC Premier Debt Fund. The Income Tax Officer asked Mr. Abhishek to pay capital gain tax on such transaction because this transaction amounts to "exchange" and therefore covered under the definition of "transfer". Whether contention of Income Tax Officer is valid?

Continuing above problem, Mr. Abhishek sold 500 units of ABC Premier Debt Fund on 13-12-2017 for Rs. 10.50 per unit. Find out capital gain in the hands of Mr. Abhishek.

Solution

All the conditions of section 47(xix) are satisfied, hence no capital gain shall be taxed in the hands of Mr. Abhishek. Thus, the contention raised by the Income Tax officer is not valid.

Computation of Capital Gain

Period of Holding: From 10-08-2015 to 13-12-2017 Type of Capital Asset : Short Term	
Particulars	**Rs.**
Full value of consideration (5000 × Rs.10.50)	52,500
Less: Cost of Acquisition (Working Note)	37,500
Taxable STCG	**15,000**

Working Note:

Total Cost of 13,333.33 units of ABC Premier Debt Fund	= Cost of 10,000 units of ABC Debt Growth Fund =10,000 × Rs. 10 = Rs. 1,00,000
Hence, cost per unit of ABC Premier Debt Fund	= $\frac{\text{Rs.1,00,000}}{13,333.33}$ = Rs. 7.50
Hence, cost of acquisition of 5000 units of ABC Premier Debt Fund	= 5000 × Rs.7.50=Rs.37,500

Readers Note:

6.26 WHAT IS THE COST OF ACQUISITION OF CAPITAL ASSETS OF CHARITABLE TRUSTS ON WHICH TAX HAS BEEN LEVIED UNDER SECTION 115TD?

Section:- 49(8) – w.r.e.f A.Y.2017-18

Where the capital gain arises from the transfer of an asset, being the asset held by a trust or an institution in respect of which accreted income has been computed and the tax has been paid thereon in accordance with the provisions of Chapter XII-EB, **the cost of acquisition of such asset shall be deemed to be the fair market value of the asset which has been taken into account for computation of accreted income as on the specified date referred to in sub-section (2) of section 115TD**.

UNIT D – EXEMPTION UNDER SECTION 10

6.27 EXEMPTIONS UNDER SECTION 10

Section:- 10(33) and 10(37)

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(33)	Any assessee	Capital Gain from transfer of units of Unit Scheme 1964.	The transfer of such unit is made after 1-4-2002
10(37)	Individual / HUF	Capital Gains arising out of sale of agricultural land	(1) The land is situated in area as referred to in section 2(14)(iiia) or 2(14)(iiib) (2) Such land was used in previous two years from the date of transfer for agricultural purpose by the assessee or his parents (3) Transfer is by way of compulsory acquisition or consideration or enhanced consideration of which is approved by RBI or Central Government (4) such income arises on or after 1.4.2004

6.28 TAX INCENTIVE FOR THE DEVELOPMENT OF CAPITAL OF ANDHRA PRADESH

Section:- 10(37A), 49 (6) and 194LA

Section 10(37A) :- Exemption in respect of capital gains arising on transfer of Specified Capital Assets under the Land Pooling Scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014. [With retrospective effect from A.Y.2015-16]

As per section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2014, the specified compensation received by the landowner in lieu of acquisition of land is exempt from income tax. The Land Pooling Scheme is an alternative form of arrangement made by the Government of Andhra Pradesh for formation of new capital city of Amaravati to avoid land acquisition disputes and lessen the financial burden associated with payment of compensation under that Act.

- In Land pooling scheme, the compensation in the form of reconstituted plot or land is provided to land owners. However, the existing provisions of the Act do not provide for exemption from tax on transfer of land under the land pooling scheme as well as on transfer of Land Pooling Ownership Certificates (LPOCs) or reconstituted plot or land.
- With a view to provide relief to an individual or Hindu undivided family who was the owner of such land as on 2nd June, 2014, and has transferred their land or building or both, under the land pooling scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014, new clause (37A) has been inserted in section 10 to provide that in respect of said persons, capital gains arising from the transfer of the followings, specified capital assets, shall not be chargeable to tax under the Act:

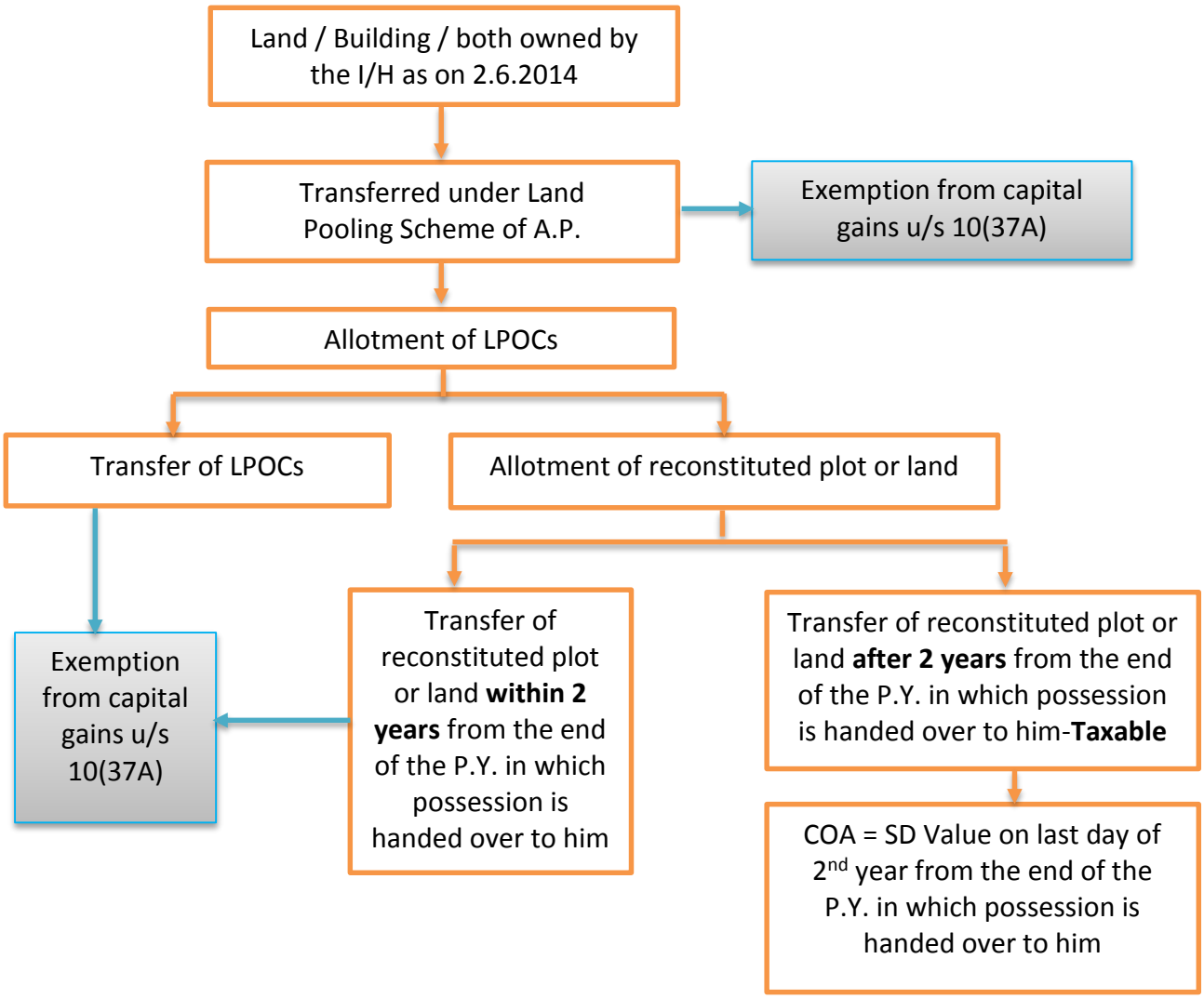
- Transfer of capital asset being land or building or both, under land pooling scheme.
- Sale of LPOCs by the said persons received in lieu of land transferred under the scheme.
- Sale of reconstituted plot or land by said persons within two years from the end of the financial year in which the possession of such plot or land was handed over to the said persons.

Section 49(6):- Cost of Acquisition of reconstituted plot or land: [With Effect from A.Y.2018-19]

Where the capital gain arises from the transfer of a reconstituted plot or land, (received by the assessee in lieu of land or building or both transferred under the Land Pooling Scheme of Andhra Pradesh) which has been transferred after the expiry of 2 years from the end of the financial year in which the possession of such plot or land was handed over to the assessee, the cost of acquisition of such reconstituted plot or land shall be deemed to be its stamp duty value as on the last day of the second financial year after the end of the financial year in which the possession of the said plot or land was handed over to the assessee.

For this purpose, "stamp duty value" means the value adopted or assessed or reassessable by the authority of the State Government for the purpose of payment of stamp duty in respect of an immovable property.

Section 194LA :- No Tax deduction shall be made in respect of any award or agreement which has been exempted from income-tax under section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. **(Effective from 1st April, 2017)**



Practical 25

Mr. Aadinath provides following information:

(a) He purchased plot of land for Rs. 10,000 on 3rd January, 1998 in Amarawati.

(b) This plot of land was transferred under land pooling scheme on 10th July, 2014.

(c) As a result, Land Pooling Ownership Certificate (LPOC) was issued to him.

(d) He then transferred this LPOC for Rs. 12,00,000 on 15th September,2015.

Discuss tax consequences of the above transaction in the hands of Mr. Aadinath.

Solution

Previous year 2014-15

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of land under Land Pooling Scheme is exempt. Therefore, transfer of land by Mr. Aadinath under land poling scheme will not result into any tax liability.

Previous year 2015-16

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of LPOC is also exempt. Therefore, transfer of such LPOC by Mr. Aadinath will not result into any tax liability.

Reader's Note:

Practical 26

Continuing above problem, assuming that Mr. Aadinath had not transferred LPOC. The Andhra Pradesh Government allotted him a reconstituted plot of land on 15th March, 2016, however, the possession of reconstituted plot was handed over to him on 2nd April, 2016. Discuss Tax consequences in the hands of Mr. Aadinath under following alternatives

(a) Mr. Aadinath has transferred reconstituted plot on 10th March, 2019 for Rs. 20,21,000

(b) Mr. Aadinath has transferred reconstituted plot on 15th April, 2019 for Rs. 21,51,000

Note: Stamp duty valuation of such reconstituted plot on 31st March, 2019 was Rs. 20,25,000

Solution

Alternative (a)

Previous year 2018-19

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of reconstituted plot is exempt provided such reconstituted plot has been transferred within 2 years from the end of financial year in which the possession of such plot was handed over to him.

Therefore, under this alternative, Mr. Aadinath is not required to pay any capital gain tax liability on transfer of such reconstituted plot.

Alternative (b)

Previous year 2019-20

Since transfer of reconstituted plot has been made after the end of 2 years from the end of financial year in which possession of reconstituted plot was handed over to Mr. Aadinath, he is liable to pay tax on capital gain arising on such transfer.

For the purpose of computing capital gain, following points merit consideration:

(i) Period of Holding: 2nd April, 2016 to 15th April, 2019

(ii) Full value of Consideration : Rs. 21,51,000

(iii) Cost of acquisition as per the provision of section 49(6) of the Act : Rs. 20,25,000

Reader's Note:

6.29 EXEMPTION FROM LONG TERM CAPITAL GAINS SCHME MODIFIED

Section:- 10(38)

Under the existing provisions of the Section 10(38) of the Income-tax Act, 1961, the income arising from a transfer of long term capital asset, being equity share of a company or a unit of an equity oriented fund, is exempt from tax if the transaction of sale is undertaken on or after 1st October, 2014 and is chargeable to Securities Transaction Tax under Chapter VII of the Finance (No.2) Act, 2004.

It has been noticed that exemption provided under section 10(38) is being misused by certain persons for declaring their unaccounted income as exempt long-term capital gains by entering into sham transactions.

With a view to prevent this abuse, it is proposed to amend section 10(38) to provide that exemption under this section for income arising on transfer of equity share acquired or on after 1st day of October, 2004 shall be available only if the acquisition of share is chargeable to Securities Transactions Tax under Chapter VII of the Finance (No 2) Act, 2004.

However, to protect the exemption for genuine cases where the Securities Transactions Tax could not have been paid like acquisition of share in IPO, FPO, bonus or right issue by a listed company acquisition by non-resident in accordance with FDI policy of the Government etc., it is also proposed to notify transfers for which the condition of chargeability to Securities Transactions Tax on acquisition shall not be applicable.

As on 05/06/2017 Government issued a notification no. 43/2017. In preamble of said notification, the Government notifies all transactions (with few specific exclusion and few specific inclusion) of acquisition of equity share entered into on or after the 1st day of October, 2004 which are not chargeable to STT EXCEPT the **Column 1** transactions but including the **column 2** transactions;

Column 1	Column 2
Specific exclusion – STT on acquisition not paid, not eligible for 10(38) exemption	**Specific Inclusion – STT on acquisition not paid, still eligible for 10(38) exemption**
Acquisition of existing listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue	Acquisition of listed equity shares in a company which has been approved by the Supreme Court, High Court, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf
	Acquisition of listed equity shares in a company by any non-resident in accordance with foreign direct investment guidelines issued by the Government of India
	Acquisition of listed equity shares in a company by an investment fund referred to in clause (a) of Explanation 1 to section 115UB of the Act or a venture capital fund referred to in clause (23FB) of section 10 of the Act or a Qualified Institutional Buyer
	Acquisition of listed equity shares in a company through preferential issue to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply
Where transaction for acquisition of existing listed equity share in a company is not entered through a recognised stock exchange of India	Following acquisition of listed equity shares in a company made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 - acquisition through an issue of share by a company other than the issue referred to in clause (a) i.e. preferential allotment. - acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business - acquisition which has been approved by the Supreme Court, High Courts, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf - acquisition under employee stock option scheme or employee stock purchase scheme framed under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 - acquisition by any non-resident in accordance with foreign direct investment guidelines of the Government of India

	- where acquisition of shares of company is made under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011 - acquisition from the Government - acquisition by an investment fund referred to in clause (a) to Explanation 1 to section 115UB of the Income-tax Act or a venture capital fund referred to in clause (23FB) of section 10 of the income-tax Act or a Qualified Institutional Buyer - acquisition by mode of transfer referred to in sections 47 or 50B of the Income-tax Act, if the previous owner of such shares has not acquired them by any mode referred to in clause (a) or clause (b) or clause (c) [other than the transactions referred to in the proviso to clause (a) or clause (b)].
Acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules made thereunder	-

Explanation,—For the purposes of this notification,—

(a) "frequently traded shares" means shares of a company, in which the traded turnover on a recognised stock exchange during the twelve calendar months preceding the calendar month in which the acquisition and transfer is made, is at least ten per cent. of the total number of shares of such class of the company: Provided that where the share capital of a particular class of shares of the company is not identical throughout such period, the weighted average number of total shares of such class of the company shall represent the total number of shares.

(b) "listed" means listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder

(c) "preferential issue" and "Qualified Institutional Buyer" shall have the meanings respectively assigned to them in sub-regulation (1) of regulation (2) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

(d) "public financial institution" and "scheduled bank" shall have the meanings respectively assigned to them in Explanation to clause(viia) of sub-section (1) of section 36 of Income-tax Act.

(e) "recognised stock exchange" shall have the same meaning assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956

(f) "reconstruction company" and "securitisation company" shall have the meanings respectively assigned to them in sub-section (1) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

UNIT E – EXEMPTION UNDER SECTION 54 TO 54GB

6.30 EXEMPTIONS FROM CAPITAL GAIN

Section:- 54

Q 1. Who can claim exemption?

Ans. Individual or HUF

Q2. What is the nature of capital asset which has been transferred?

Ans. Long Term Capital Asset

Q3. Which specific asset is eligible for exemption (that means which asset has been transferred?)

Ans. A Residential House Property

Q4. Which asset the tax-payer shall acquire to avail exemption under this section?

Ans. One Residential House in India

Q5. What is time-limit for acquiring the new capital asset?

Ans. For purchase: 1 year backward or 2 years forward from date of transfer

For construction: 3 years forward from date of transfer

Q6. What is the quantum of exemption?

Ans. Exemption under section 54 = Amount invested in new asset or capital gain whichever is lower

Practical 27

Raghvan owned a residential house at Madurai. The original cost of which was Rs.1,00,000. It was acquired on 01.09.2008. He sold the house on 01.06.2017 for Rs.10,00,000 and purchased another house on 30.05.2017 at Trichy for Rs.6,00,000. Find out Capital gain in the hands of Raghvan.
[CA Inter, May 2000]

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of a Mr. Raghvan

Period of Holding: 01.09.2008 to 01.06.2017 Nature of Capital Asset: Long Term	
Particulars	**Rs.**
Full value of consideration	10,00,000
Less: Expenses in connection with Transfer	-
Net Consideration	10,00,000
Less: Indexed Cost of acquisition $1{,}00{,}000 \times \frac{272}{137}$	(1,98,540)
Long Term Capital Gain Before Exemption	**8,01,460**
Less: Exemption u/s 54	**6,00,000**
Long Term Capital Gain Before Exemption	**2,01,460**

Readers Note:

Q7. Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

Ans. If new asset is transferred within 3 years **from the date of its acquisition.**

Q7.1.What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Short term

Q7.2 What is the computation methodology when exemption under section 54 is revoked?

For this purpose, while computing capital gain in respect of transferred asset, its cost of acquisition shall be reduced by the amount of exemption claimed earlier.

Practical 28

In continuation of problem, the second house at Trichy was sold by him for Rs.8,00,000 on 30.06.2018. Discuss the impact of this transaction with regard to assessment to capital gains.

Solution

Computation of Capital Gain for the Previous Year 2018-19 in the hands of a Mr. Raghvan

Period of Holding: 30.05.2017 to 30.06.2018 Nature of Capital Asset: Short Term		
Particulars		**Rs.**
Full value of consideration		8,00,000
Less: Expenses in connection with Transfer		-
Net Consideration		8,00,000
Less: Cost of acquisition	[6,00,000 – 6,00,000]	-
Short Term Capital Gain		**8,00,000**

Readers Note:

Q8. Is scheme of Deposit available?

Ans. If the new asset is not acquired on or before the due date of filing return under section 139(1), then the taxpayer will have to deposit the money in "Capital gain deposit account scheme" with a nationalized bank. Exemption under section 54 shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q 5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 year time – limit from date of transfer.

It will be taxable as long – term capital gain.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 year time-limit.

Practical 29

Rima provides following information about residential house property at Ahmedabad:

Date of transfer	: -	**25th August, 2017**
Sale Consideration	: -	Rs. 40,00,000
Stamp Duty Value	: -	Rs. 45,00,000
Indexed Cost of Acquisition	: -	Rs.3,84,698
Expenses in connection with transfer	: -	Rs. 50,000

In order to avail exemption under section 54, Rima deposited Rs. 35,00,000 with capital gains deposit account scheme on **20th July, 2018**.

Thereafter, she withdrawn Rs.30 Lacs from the deposit account and purchased property at Baroda on **15th August, 2019**.

You are required to answer following questions:-

1. Determine capital gain chargeable to tax for different assessment years.
2. What is the earliest date when Rima can withdraw the unutilized amount?

Solution

1. Computation of Capital Gain for the Previous Year 2017-18 in the hands of Rima

Period of Holding: Not given
Nature of Capital Asset: Long Term

Particulars	Rs.
Full value of consideration	45,00,000
Less: Expenses in connection with Transfer	(50,000)
Net Consideration	44,50,000
Less: Indexed Cost of acquisition	(3,84,698)
Long Term Capital Gain Before Exemption	**40,65,302**
Less: Exemption u/s 54	(35,00,000)
Long Term Capital Gain	**5,65,302**

Computation of Capital Gain for the Previous Year 2020-21 in the hands of Rima

Nature of Capital Asset: Short Term

Particulars	Rs.
Unspent Amount (Rs. 35,00,000 less Rs.30,00,000)	5,00,000
Long Term Capital Gain	**5,00,000**

2. Rima can withdraw unutilized amount earliest by 25th August, 2020.

Readers Note:

Practical 30

Mr. Ghanshyam, 62 years sold out his residential house property being long term capital asset. He seeks your advice on following issues while claiming exemption under section 54

(a) He wants to purchase three residential houses in India out of sale proceeds of his old property. Can he claim exemption under section 54 for all these three residential properties?

(b) Further, he wants to buy one more residential house at USA. Can this house is eligible for exemption under section 54?

Solution

(a) Considering the amendment, Mr. Ghanshyam can avail exemption under section 54 in respect of one residential house property only. Therefore, he shall be advised to select any one house which carries highest investment while claiming exemption under section 54.

(b) Further, Ghanshyam can take exemption under section 54 in respect of investment made in "one residential house **in INDIA".** Therefore, house property to be purchased at USA will not qualify for exemption under section 54.

Readers Note:

6.31 EXEMPTIONS FROM CAPITAL GAIN

Section:- 54F

Q 1. Who can claim exemption?

Ans. Individual or HUF

Q2. What is the nature of capital asset which has been transferred?

Ans. Long Term Capital Asset

Q3. Which specific asset is eligible for exemption (that means which asset has been transferred?)

Ans. Any Long Term Capital Asset other than residential house property.

However, there is one condition that on the date of sale of any long term capital asset, he should not own more than one house residential property.

Q4. Which asset the tax-payer shall acquire to avail exemption under this section?

Ans. One Residential House in India

Q5. What is time-limit for acquiring the new capital asset?

Ans. For purchase: 1 year backward or 2 years forward from date of transfer

For construction: 3 years forward from date of transfer

Q6. What is the quantum of exemption?

Ans. Exemption under section 54F = $\frac{\text{CG X Amount invested in new asset}}{\text{Net Consideration}}$

Q7. Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

Ans. In following three situations exemption availed under section 54F may be withdrawn:

(a) If new asset is transferred within 3 years from the date of its acquisition**.**
(b) If another residential house property has been purchased within 2 years from the date of transfer of original asset

(c) If another residential house property has been constructed within 3 years from the date of transfer of original asset.

Q7.1.What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Long Term

Q8. Is scheme of Deposit available?

Ans. If the new asset is not acquired on or before the due date of filing return under section 139(1), then the taxpayer will have to deposit the money in "Capital gain deposit account scheme" with a nationalized bank. Exemption under section 54 shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q 5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 year time – limit from date of transfer.

It will be taxable as long – term capital gain.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 year time-limit.

Practical 31

X sells shares in a private company on July 10, 2017 for Rs. 8,05,000.
(Cost of acquisition on June 15, 2008: Rs. 60,000, expenses on sale: Rs. 5,000).
On July 10, 2017, he owns one residential house property. To get the benefit of exemption under section 54F, X deposits on July 30, 2018 Rs. 6,00,000 in capital gains deposit Account Scheme. By withdrawing from the deposit account, he purchases a residential house property at Delhi on July 6, 2019 for Rs. 4,80,000. Ascertain-

(a) The amount of capital gain chargeable to tax for P.Y. 2017-18.
(b) Tax treatment of the unutilized amount;
(c) When can he withdraw the unutilized amount; and
(d) What X has to do to ensure that exemption u/s 54F is never taken back. **[ICWA, June 2004]**

Solution

(a) Computation of Capital Gain for the Previous Year 2017-18 in the hands of a Mr. X

Period of Holding : 15.06.2008 to 10.07.2017
Nature of Capital Asset: Long Term

Particulars		(Rs.)
Full value of consideration		8,05,000
Less: Expenses in connection with Transfer		(5,000)
Net Consideration		8,00,000
Less: Indexed Cost of acquisition	$60{,}000 \times \frac{272}{137}$	(1,19,124)
Long Term Capital Gain Before Exemption		**6,80,875**
Less: Exemption u/s 54F	$6{,}00{,}000 \times \frac{6{,}80{,}875}{8{,}00{,}000}$	(5,10,656)
Long Term Capital Gain		**1,70,219**

(b) Tax Treatment of unutilized amount

Computation of Capital Gains during the previous year 2020-21 in the hands of Mr. X

Nature of Capital Asset: Long Term

Particulars		(Rs.)
Amount Deposited in Capital Account Scheme		6,00,000
Less: Utilized by purchasing residential house property		4,80,000
Unutilized Amount		1,20,000
Long Term Capital Gain	$1,20,000 \times \frac{6,80,875}{8,00,000}$	**1,02,131**

(c) Mr. X can withdraw unutilized amount on or after 10th July, 2020.

(d) Mr. X shall consider the following points in order to ensure that the exemption under section 54F is never taken back

(i) The new residential house property shall not be transferred till 5th July, 2022.

(ii) Mr. X shall not purchase another residential house property upto 9th July, 2018.

(iii) Mr. X shall not construct another residential house property upto 9th July, 2020.

Readers Note:

6.32 EXEMPTIONS FROM CAPITAL GAIN

Section:- 54EC

Q 1. Who can claim exemption?

Ans. Any person

Q2. What is the nature of capital asset which has been transferred?

Ans. Long Term Capital Asset

Q3. Which specific asset is eligible for exemption (that means which asset has been transferred?)

Ans. Any Long Term Capital Asset

Q4. Which asset the tax-payer shall acquire to avail exemption under this section?

Ans. Bonds of National High-way Authority of India (NHAI) or Rural Electrification Corporation Limited or **any other notified by the Central Government in this behalf.**

Notification No. 47/2017 dated 8th June, 2017:- Bonds (redeemable after three years) issued on or after 15th day of June, 2017 by Power Finance Corporation Limited are eligible for availing benefit u/s 54EC.

Notification No. 79/2017 dated 8th August, 2017:- Bonds (redeemable after three years) issued on or after 8th day of August, 2017 by Indian Railway Finance Corporation Limited are eligible for availing benefit u/s 54EC

Q5. What is time-limit for acquiring the new capital asset?

Ans. Six months from the date of transfer

Q6. What is the quantum of exemption?

Ans. Exemption under section 54EC = Amount invested in new asset or capital gain whichever is lower
Upper Limit for exemption: Under no circumstances, exemption under 54EC shall exceed Rs. 50 Lac in a financial year.

Q7. Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

Ans. If new asset is transferred or converted into money or loan is taken on the security of new asset within 3 years from the date of its acquisition.

Q7.1.What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Long term

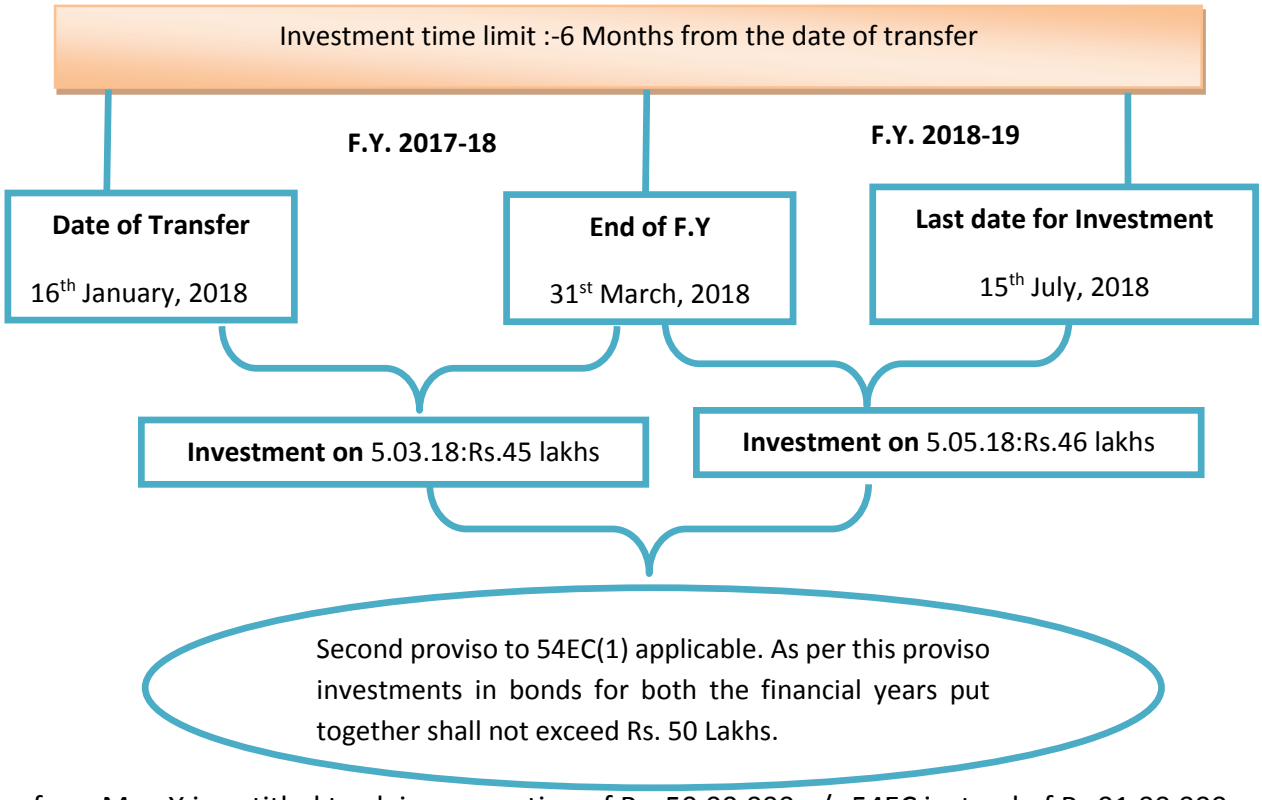
Q8. Is scheme of Deposit available?

Ans. No

Practical 32

Mrs. X, resident woman, transfers (Date of transfer:-January 16, 2018) a house property resulting into long term capital gain of Rs. 1,01,50,000. She invests a sum of Rs. 45,00,000 in capital gains bonds issue by Power Finance Corporation Limited on March 5, 2018. She further invests a sum of Rs. 46,00,000 in the same bonds on May 5, 2018. Accordingly, she wants to claim exemption of Rs. 91,00,000 under 54EC. Advise her suitably.

Solution



Therefore, Mrs. X is entitled to claim exemption of Rs. 50,00,000 u/s 54EC instead of Rs 91,00,000.

Readers Note:

6.33 EXEMPTION OF LONG-TERM CAPITAL GAINS ON INVESTMENT IN NOTIFIED UNITS OF SPECIFIED FUND (FUND TO BE ESTABLISHED FOR "START UP INDIA ACTION PLAN")

Section:- 54EE - Effective From A.Y.2017-18

Q 1. Who can claim exemption?

Ans. Any person

Q2. What is the nature of capital asset which has been transferred?

Ans. Long Term Capital Asset

Q3. Which specific asset is eligible for exemption (that means which asset has been transferred?)

Ans. Any Capital Asset

Q4. Which asset the tax-payer shall acquire to avail exemption under this section?

Ans. Units issued before 1st day of April 2019, of such fund as Central Government may notify (Fund to be established for "Start up India Action plan")

Q5. What is time-limit for acquiring the new capital asset?

Ans. Six months from the date of transfer

Q6. What is the quantum of exemption?

Ans. Exemption under section 54EE = Amount invested in units of notified fund or capital gain whichever is lower.

Upper Limit for exemption: Under no circumstances, exemption under 54EE shall exceed Rs. 50 Lac in a financial year.

Q7. Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

Ans. If such units of notified funds are transferred or loan is taken on the security of new asset within 3 years **from the date of its acquisition.**

Q7.1.What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Long term

Q8. Is scheme of Deposit available?

Ans. No.

6.34 EXEMPTIONS FROM CAPITAL GAIN

Section:- 54G

Q 1. Who can claim exemption?

Ans. Any person

Q2. What is the nature of capital asset which has been transferred?

Ans. Short Term / Long Term Capital Asset

Q3. Which specific asset is eligible for exemption (that means which asset has been transferred?)

Ans. Land, building, plant or machinery in order to shift an industrial undertaking from urban are to rural area.

Q4. Land, building, plant or machinery in rural area.

Q4.1. What is time-limit for acquiring the new capital asset?

Ans. For purchase: 1 year backward or 3 years forward from date of transfer

Q5. What is the quantum of exemption?

Ans. Readers are advised to follow below mentioned chart strictly

Particulars	**Amount Rs.**
Compute Capital gain on sale of Land	
Compute Capital gain on sale of Building	
Compute Capital gain on sale of P & M	
Aggregate all of above (A)	
Less: Exemption under section 54G (Refer working note) **(B)** **Remark: Exemption shall not exceed (A)**	
Balance Taxable Capital Gain **(C)= (A-B)**	
Compute Capital gain on sale of other asset, if any **(D)**	
Total Capital Gain Chargeable to Tax = **(C)** plus **(D)**	

Working Note: Exemption under section 54G is aggregate of the followings:

Particulars	Amount Rs.
Amount invested in Land at Rural Area	
Amount invested in Building at Rural Area	
Amount invested in Plant & Machinery at Rural Area	
Amount of Shifting Expenditure incurred **(don't forget this)**	
Total	

Q6. Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

Ans. If new asset is transferred within 3 years from the date of its acquisition.

Q6.1.What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Short term

Q7. Is scheme of Deposit available?

Ans. If the new asset is not acquired on or before the due date of filing return under section 139(1), then the taxpayer will have to deposit the money in "Capital gain deposit account scheme" with a nationalized bank. Exemption under this section shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q 5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 year time – limit from date of transfer.

It will be taxable as short term or long – term capital depending upon original gain.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 year time-limit.

Practical 33

X Ltd, located within the corporation limits, decided in December, 2017 to shift its industrial undertaking to non-/urban area. The company sold some of the assets and acquired new assets in the process of shifting. Further, it incurred Rs. 25,000 as shifting expenses. The relevant details are as follows:

(Rs. In lakhs)

Particulars	Land	Building	Plant & Machinery	Furniture
Sale proceeds (sale effected in March, 2018)	8	18	16	3
Indexed cost of acquisition	4	10	12	2
Cost of acquisition in terms of section 50	-	4	5	2
Cost of new assets purchased in July, 2018 for the purpose of business in the new place	4	7	17	2

Compute the capital gains of X Ltd. for the previous year 2017-18.

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of X Ltd.

Particulars	Amount (Rs.)
Long Term Capital gain on sale of Land (Rs.8,00,000 less Rs. 4,00,000)	4,00,0000
Short Term Capital gain on sale of Building (Rs. 18,00,0000 less Rs. 4,00,000)	14,00,000
Short Term Capital gain on sale of P & M (Rs.16,00,000 less Rs. 5,00,000)	11,00,000
Aggregate all of above (A)	**29,00,000**

Less: Exemption under section 54G (Refer working note) **(B)** **Remark: Exemption shall not exceed (A)**	28,25,000
Balance Taxable Capital Gain **(C)= (A-B)**	**75,000**
Short Term Capital gain on sale of Furniture (Rs. 3,00,000 less Rs.2,00,000) **(D)**	1,00,000
Total Capital Gain Chargeable to Tax = **(C)** plus **(D)**	**1,75,000**

Working Note: Exemption under section 54G is aggregate of the followings:

Particulars	**Amount (Rs.)**
Amount invested in Land at Rural Area	4,00,000
Amount invested in Building at Rural Area	7,00,000
Amount invested in Plant & Machinery at Rural Area	17,00,000
Amount of Shifting Expenditure incurred **(don't forget this)**	25,000
Total	**28,25,000**

Readers Note:

6.35 EXEMPTION OF LONG-TERM CAPITAL GAINS ON TRANSFER OF RESIDENTIAL PROPERTY IF THE SALE CONSIDERATION IS USED FOR SUBSCRIPTION IN EQUITY OF A NEW START-UP MANUFACTURING SME COMPANY / ELIGIBLE START UP TO BE USED FOR PURCHASE OF NEW PLANT AND MACHINERY

Section:- 54GB

Q 1. Who can claim exemption?

Ans. Individual or HUF

Q2. What is the nature of capital asset which has been transferred?

Ans. Long Term Capital Asset

Q3. Which specific asset is eligible for exemption?

Ans. Residential House Property or plot of land provided transfer takes place on or before 31-03-2017.

However, for an eligible start up last date of transfer shall be 31-03-2019 instead of 3103-2017.

Q4. Which asset the tax-payer shall acquire to avail exemption under this section?

Ans. Equity shares of eligible company.

"eligible company" means a company which fulfils the following conditions, namely:—

(i) *it is a company incorporated in India on or after 1st April of the previous year (during which the capital gain arises) but on or before due date of furnishing of return of income under sub-section (1)of section 139;*

(ii) *it is engaged in the business of manufacture of an article or a thing or* ***in an eligible business (Amendment by Finance Act, 2016 w.e.f. A.Y. 2017-18)****;*

(iii) *it is a company in which the assessee has more than fifty per cent share capital or more than fifty per cent voting rights after the subscription in shares by the assessee; and*

(iv) *it is a company which qualifies to be a small or medium enterprise under the Micro, Small and Medium Enterprises Act, 2006 (Where the investment in plant and machinery is more than Rs. 25 Lakh but not more than Rs. 10 crore) or* ***is an eligible start-up. (Amendment by Finance Act, 2016 w.e.f. A.Y. 2017-18)***

Q4.1. What is time-limit for acquiring the new capital asset?

Ans. Equity shares of eligible company shall be acquired on or before the due date of furnishing return of income.

Further, Eligible company shall utilize this amount for purchase of a "new asset" within 1 year from date of subscription of equity shares

"new asset" means new plant and machinery but does not include—

(i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;

(ii) any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest-house;

(iii) any office appliances including computers or computer software; ***(However, for eligible start up new asset shall include computers or computer software – Amendment by Finance Act, 2016)***

(iv) any vehicle; or

(v) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

Q5. What is the quantum of exemption?

Ans. Exemption under section 54 GB = Investment in new Asset * Capital gain / Net consideration

Q6. Is it possible to revoke the exemption in a subsequent year?

Ans. In following cases, exemption is taken back

a. If equity shares of eligible company are sold or otherwise transferred within 5 years from the date of its acquisition
b. If new asset is sold or otherwise transferred within 5 years from the date of its acquisition

Q6.1.What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Long term

Q7. Is scheme of Deposit available?

Ans. The eligible company shall utilize this amount for purchase of a "new asset" within 1 year from date of subscription of equity shares. If however, company does not utilize this amount for the purchase of a "new asset" before due date of furnishing of return under section 139 (1), it shall be deposited by the company in capital gain deposit account. In such a case, exemption shall be granted based on amount deposited in the deposit account.

If the deposit account is not utilized fully or partly for purchasing "new asset" within 1 year from the subscription of equity shares then exemption will be taken back and charged to tax as long term capital gain in the previous year in which this period of 1 year expires.

Practical 34

Mr. Akash sold his residential property on 2nd February, 2018 for Rs. 90 lakh and paid brokerage@1% of sale price. Indexed Cost of acquisition of the said house property was Rs. 51,12,000. In June, 2018, he invested Rs. 75 lakh in equity of A (P) Ltd., an eligible start up, which constituted 63% of share capital of the said company. A (P) Ltd. utilized the said sum for the following purposes –

(a) Purchase of new plant and machinery during July 2018 – Rs. 59 lakh
(b) Included in (a) above are Rs. 6 lakh for purchase of computers and Rs. 8 lakh for purchase of cars.
(c) Air-conditioners purchased for Rs. 1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.
(d) Amount deposited in specified bank on 28.9.2018– Rs. 10 lakh

Compute the chargeable capital gain for the A.Y.2018-19. Assume that Mr. Akash is liable to file his return of income on or before 30th September, 2018.

Solution

Computation of taxable capital gains for A.Y.2018-19

Particulars	Rs.
Full value of consideration	90,00,000
Less: Expenses on transfer (1% of the FVC)	(90,000)
Net consideration	89,10,000
Less: Indexed cost of acquisition	(51,12,000)
Long Term Capital Gain before exemption	37,98,000
Less: Exemption under section 54GB (Rs. 37,98,000 × Rs. 60,00,000 /Rs. 89,10,000	25,57,576
Taxable capital gains	12,40,424

Deemed cost of new plant and machinery for exemption under section 54GB

	Particulars	Rs.	Rs.
(1)	Purchase cost of new plant and machinery acquired in July, 2018		59,00,000
	Less:		
	Cost of vehicles, i.e., cars	8,00,000	
	Cost of air-conditioners installed at the residence of Mr. Akash	1,00,000	(9,00,000)
			50,00,000
(2)	Amount deposited in the specified bank before the due date of filing of return		10,00,000
	Deemed cost of new plant and machinery for exemption under section 54GB		**60,00,000**

Readers Note:

UNIT E – IMPORTANT CIRCULARS AND JUDICIAL PRECEDENTS

6.36 IMPORTANT CIRCULARS

1. **Circular No. 791, dated June 2, 2000.**
   The period of 6 months for making investments is specified assets for the purpose of sections 54EA, 54EB, 54EC should be taken from the date such stock-in-trade is sold or otherwise transferred, in terms of section 45(2). However, the benefit given by Circular No. 791 cannot be extended for claiming exemption under section 54, 54B, 54D and 54F.

2. **Circular No. 471, dated October 15, 1986 and Circular No. 672 dated Decemeber 16, 1993.**
   Case of allotment of flat under the self-financing scheme of DDA (or similar scheme of co-operative societies or other institutions) is treated as construction of house for this purpose.

3. **Circular No. 743, dated May 6, 1996**

   If the assessee dies before the expiry of stipulated period (for purchasing the new asset, and later on the unutilized amount is refunded to the legal heirs, the Board is of opinion that in such cases the said amount cannot be taxed in the hands of the deceased. This amount is not taxable in the hands of legal heirs also as the unutilized portion of the deposit does not partake the character of income in their hands but is only a part of the estate devolving upon them.

4. **Circular on holding period for shares / securities:**

SR No.	***Different situations***	***Relevant date***
1.	Date of purchase (through stock exchanges) of shares / securities.	Date of purchase by broker on behalf of investor.
2.	Date of transfer (through stock exchanges) of shares / securities.	Date of broker's note.
3.	Date of purchase / transfer of shares / securities (transaction taken place directly between parties and not through stock exchanges).	Date of contract of sale as declared by parties.
4.	Date of purchase / sale of shares / securities purchased in several lots at different points of time but delivery taken in one lot and subsequently sold in parts.	The first-in-first-out (FIFO) method shall be adopted to reckon the period of the holding of the security.

Board's clarification on FIFO system for dematerialized stock:
If in an existing account of dematerialized stock, old physical stock is dematerialized and entered at a later date, under the FIFO method, the basis for determining the movement out of the account is the date of entry into the account. This is illustrated by the following example:

Date of credit	Particulars	Quantity
June 1, 1997	Purchased directly in Dematerialized form on May 25, 1997	1,000
June 5, 1997	Dematerialized share originally purchased in November, 1985	5,000
June 10, 1997	Purchased directly in Dematerialized form on June 10, 1997	4,000
June 15, 1997	Dematerialized share originally purchased in May, 1962	3,000

If say 2,500 shares were sold from out of this account on 25th june 1997, then the period of holding of the first 1,000 shares should be as from May 25, 1997 to 25th June, 1997, whereas the balance 1500 shares will be treated as having been acquired in November 1985 and therefore period of holding shall be from November 1985 to 25th June, 1997. This is the effect of the FIFO method.

5. Circular No. 06/2016, dated 29-2-2016

Surplus on sale of shares and securities - whether taxable as capital gains or business income?

Section 2(14) defines the term "capital asset" to include property of any kind held by an assessee, whether or not connected with his business or profession, but does not include any stock-in-trade or personal assets subject to certain exceptions. As regards shares and other securities, the same can be held either as capital assets or stock-in-trade/trading assets or both.

Determination of the character of a particular investment in shares or other securities, whether the same is in the nature of a capital asset or stock-in-trade, is essentially a fact-specific determination and has led to a lot of uncertainty and litigation in the past.

Parameters laid down by CBDT and Courts to distinguish shares held as investments and shares held as stock in trade

Over the years, the courts have laid down different parameters to distinguish the shares held as investments from the shares held as stock-in-trade. The CBDT has also, through Instruction No. 1827, dated August 31, 1989 and Circular No. 4 of 2007 dated June 15, 2007, summarized the said principles for guidance of the field formations.

Principles to determine whether gains on sale of listed shares and other securities would constitute capital gains or business income

Disputes, however, continue to exist on the application of these principles to the facts of an individual case since the taxpayers find it difficult to prove the intention in acquiring such shares/securities. In this background, while recognizing that no universal principle in absolute terms can be laid down to decide the character of income from sale of shares and securities (i.e. whether the same is in the nature of capital gain or business income), CBDT realizing that major part of shares/securities transactions takes place in respect of the listed ones and with a view to reduce litigation and uncertainty in the matter, in partial modification to the aforesaid Circulars, further instructs the Assessing Officers to take into account the following while deciding whether the surplus generated from sale of listed shares or other securities would be treated as Capital Gain or Business Income —

a) **Where assessee opts to treat such shares and securities as stock-in-trade:** Where the assessee itself, irrespective of the period of holding the listed shares and securities, opts to treat them as stock-in-trade, the income arising from transfer of such shares/securities would be treated as its business income,

b) **Listed shares and securities held for a period of more than 12 months:** In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall not be put to dispute by the Assessing Officer. However, this stand, once taken by the assessee in a particular Assessment Year, shall remain applicable in subsequent Assessment Years also and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in subsequent years;

c) **Other cases:** In all other cases, the nature of transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid Circulars issued by the CBDT.

Principles listed above not to apply in case of sham transactions

It is, however, clarified that the above shall not apply in respect of such transactions in shares/securities where the genuineness of the transaction itself is questionable, such as bogus claims of Long Term Capital Gain/Short Term Capital Loss or any other sham transactions.

Objective of formulation of principles: Reducing litigation and ensuring consistency

It is reiterated that the above principles have been formulated with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from transfer of shares and securities. All the relevant provisions of the Act shall continue to apply on the transactions involving transfer of shares and securities.

Summary:

Types of shares/ securities	**Listed**			**Unlisted**
Classification	Assessee treats as S-I-T	Assessee treats as Capital Asset		
Period of which held		Held for less than 12 months	Held for more than 12 months	Irrespective of period of holding
Taxable as	Business Income	To decide based on established tests	Capital Gains	Capital Gains

1) Bogus transactions – to deal on merits – above circular not applicable ;
2) Transfer of unlisted shares requiring lifting of corporate veil – above circular not applicable;
3) Transfer of unlisted shares along with control and management – above circular not applicable

6.37 JUDICIAL PRECEDENTS

(1) Section 2(14): Definition of Capital Asset

Case Study 1

Maharani Usha Devi sold some clothes which were used for some social or formal occasions only. She claims that there is no capital gain in her hand because she transferred personal effects. On the other hand, contention of Income Tax Officer is that clothes are not meant for daily use therefore they are not personal effects. Verify the contention of Maharani vis-à-vis that of Income Tax Officer.

[Source:- CIT v. H.H. Maharani Usha Devi [1998] 98 Taxman 309 (SC).]

Solution

Supreme Court in the above case observed as under:

"For example, clothes meant for use at weddings or formal occasions are not used daily. Yet they are stitched for personal use of the wearer. As such, they would form a part of his personal effects".

Considering the above, contention of Income Tax officer to levy capital gain is not tenable.

Readers Note:

Case Study 2

Ms. Saroj Goenka sold loose diamonds. She claimed that loose diamonds are personal effects. Examine taxability of capital gain arising on transfer of loose diamonds.

[Source:- CIT v. Saroj Goenka [1983] 140 ITR 88]

Solution

Relevant Provision

For the purpose section 2(14) of the Act, "jewellery" includes—

(a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel;

(b) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

Madras High Court in the above case held as under:

"Similarly, furniture held for personal use would not be a capital asset, so that its sale cannot produce capital gains. But, jewellery is intended to be taken out of the above category. Whether it is intended for personal use or not, it would stand out of the exception and would come within the main category of "movable property". The sale of jewellery would thus be sale of capital assets and the gain would be capital gain."

Considering the above, transfer of loose diamonds are subject to capital gain tax.

Readers Note:

Case Study 3

G.M. Omer Khan purchased an agricultural land in village "Makarba". At the time of purchase, village "Makarba" was not a part of Ahmedabad Municipal Corporation. He sold out such land after 30 years

and at the time of transfer of such land, village "Makarba" is a part of Ahmedabad Municipal Corporation.

Based on above facts, discuss:-

1. Whether sale of this agricultural land at Makarba attracts capital gain tax assuming that population of village "Makraba" at the time of transfer of land is still below 10,000?
2. If captioned transaction is taxable in the hands of G.M. Omer Khan, then what are the tools of tax planning?

[Source: - G.M. Omer Khan v. CIT [1992] 63 Taxman 533 (SC).]

[Source:- Nachiappan (M) v CIT [1998] 230 ITR 98 (Mad)].

Solution

Relevant Definition

(a) Section 2(14) defines capital asset which excludes agricultural land in India.

(b) Agricultural land means the land falling ***outside*** urban area

(c) **Meaning of Urban area**

(1) Urban area means any area which is situated within the jurisdiction of a municipality or cantonment board having a population of 10,000 or more.

(2) Urban area also includes an area which is situated outside the local limits of such municipality/cantonment board but within distance given below –

Population of municipality / cantonment board	Distance measured aerially
More than 10,000 but not exceeding 1 lakh	2 kilometers
More than 1 lakh but not exceeding 10 lakh	6 kilometers
More than 10 lakhs	8 kilometers

(3) For the above purpose, "population" means the population according to the last preceding census of which the relevant figures have been published before the date of valuation.

Supreme Court in the above case observed as under:

"A close reading of s. 2(14)(iii)(a) seems to suggest that it is the population of the municipality that has to be taken into account for the purpose of that section and not the population of any area within the municipality."

Considering the definition and the observation of Supreme Court, transfer of land at Makaraba attracts capital gain tax.

Readers Note:

Case Study 4

Hindustan Industrial Resources Ltd. purchased an agricultural land with an object of setting up an industry. Shortly thereafter it was acquired under the Land Acquisition Act, 1894 and compensation was paid to the assessee by the Government. The assessee claimed that the land was an agricultural land and therefore, no taxable capital gain accrued. The Assessing Officer assessed the capital gains to tax, holding that land ceased to be agricultural land when the assessee purchased it from the agriculturist for setting up an industry. Discuss the validity of action taken by Assessing Officer.

[Source:- Hindustan Industrial Resources Ltd vs. ACIT 180 Taxman 114 (Del.)]

Solution

The Delhi High Court made following observation:

"On the date of purchase, the land in question was agricultural land and on the date of compulsory acquisition, the character of the land continued to be agricultural. Therefore, it is apparent that in the transitional period, that is, between purchase and compulsory acquisition, the nature and character of the land did not change.

The fact that the appellant/assessee intended to use the land for industrial purposes did not in any way alter the nature and character of the land.

The further fact that the appellant/assessee did not carry out any agricultural operations did not also result in any conversion of the agricultural land into an industrial land."

Considering the above, land under compulsory acquisition is still an agricultural land hence not a capital asset. Therefore, the action taken by the assessing officer is not valid.

Readers Note:

(2) Section 2(47): Definition of Transfer

Case Study 5

Discuss whether following transactions amount to transfer in the hands of shareholder?

(a) Redemption of Preference Shares

(b) Forfeiture of Shares

(c) Reduction of Share capital

Solution

(a) Redemption of Preference Shares

[Source:- ***Anarkali Sarabhai 224 ITR 422(SC)]***

Supreme Court in the above case made following observation:

The company redeemed its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. In effect, the company has bought back the preference shares from the shareholders. It may have been done at a date set by the terms of the issue. When a preference share is redeemed by a company, what a shareholder does in effect is to sell the share to the company. Such a transaction is nothing but sale of the preference shares by the shareholders to the company.

Therefore, in my judgment, the redemption of preference shares by the company will squarely come within the phrase "sale, exchange or relinquishment of the asset".

Considering the above, redemption of preference shares amounts to transfer.

(b) Forfeiture of Shares

[Source:- CIT v. BPL Sanyo Finance Ltd.[2009] 312 ITR 63]

Karnataka high court made following observation:

"There is a binding contract existed between the assessee and the investee company, the irresistible conclusion that can be drawn on the aforesaid facts and circumstances is that as soon as the allotment is made, the assessee would be deemed to have acquired a right in such share even if the call monies or the full face value of the shares has not been paid.

Thus, in a case where only share application money is paid and the balance is yet to be paid on actual allotment of shares, the holder of such allotment would be recognised as a member of the investee company.

Thus, it cannot be said that the assessee had not acquired right in such shares on account of its failure to deposit the balance amount for allotment of shares.

The aforesaid view would attract the provisions of s. 2(47) of the Act. The extinguishment of any rights therein as appeared in s. 2(47) of the Act, covers every possible transaction resulting in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise of all or any of the bundle of rights whether qualitative or quantitative, which the assessee has in a capital asset whether or not such an asset is corporeal or incorporeal."

Considering the above, forfeiture of share amounts to extinguishment of rights hence results into transfer.

(c) Reduction of Share capital

[Source:- Kartikeya V. Sarabhai v. CIT [1997] 94 Taxman 164 (SC)]

[Source: - CIT v. G.Narasimham [1999] 102 Taxman 66 (SC).]

In the case of Kartikeya Sarabhai vs. CIT (1997) 142 CTR (SC) 150 : (1997) 228 ITR 163 (SC) Supreme Court examined the question of capital gains in the context of an amount received by a shareholder from a company on reduction in the face value of shares on account of a reduction in the share capital of the company.

This Court said that it is not necessary for capital gain to arise that there must be a sale of a capital asset. Relinquishment of the asset or extinguishment of any right in it, which may not amount to a sale, can also be considered as a transfer. Any profit or gain which arises from the transfer of a capital asset is liable to be taxed under s. 45.

As a result of a reduction in the face value of the share, the share capital is reduced, the right of the shareholder to the dividends and his right to share in the distribution of net assets upon liquidation, is extinguished proportionately to the extent of reduction in the capital. Even though the shareholder remains a shareholder, his right as a holder of those shares stands reduced with the reduction in the share capital. Therefore, this extinguishment of right is transfer. The amount received by the assessee for such reduction is liable to capital gains under s. 45.

Considering the above, reduction of share capital results into extinguishment of right hence results into transfer.

Readers Note:

Case Study 6

Vijay Flexible Containers (VFC), a partnership firm, entered into a contract to purchase an immovable property for Rs. 1 crore. On date of agreement, firm paid Rs. 5,00,000 as advance to the Seller and balance to be paid within 3 months of the agreement. Vijay Flexible Containers were ready with the balance consideration but the seller did not honour the agreement (Seller refused to sell the property). Therefore, the firm filed a suit for specific performance of contract against the owner of the property. Ultimately a compromise was arrived at. In terms of the compromise, the owner agreed to pay VFC Rs.

15 lakh as compensation. State with reasons whether this transaction will attract capital gain in the hands of Vijay Flexible Containers?

[Source:- CIT v. Vijay Flexible Containers [1990] 48 Taxman 86 (Bom.)]

[Source:- CIT v. Laxmidevi Ratani [2008] 296 ITR 363 (MP)]

Solution

Bombay High Court in case of CIT v. Vijay Flexible Containers made following observation

The assessee acquired under the said agreement for sale the right to have the immovable property conveyed to him. He was, under the law, entitled to exercise that right not only against his vendors but also against a transferee with notice or a gratuitous transferee. He could assign that right. What he acquired under the said agreement for sale was, therefore, property within the meaning of the IT Act and, consequently, a capital asset.

When he filed the suit in this Court against the vendors he claimed specific performance of the said agreement for sale by conveyance to him of the immovable property and, only in the alternative, damages for breach of the agreement. A settlement was arrived at when the suit reached hearing, at which point of time the assessee gave up his right to claim specific performance and took only damages. His giving up of the right to claim specific performance by conveyance to him immovable property was a relinquishment of the capital asset. There was, therefore, a transfer of a capital asset within the meaning of the IT Act.

Considering the above, this transaction attract capital gain tax liability in the hands of Vijay Flexible Containers.

Readers Note:

Case Study 7

Mr. L. Raghukumar is a partner in ABC & Co. He retired from the firm. On retirement, he has been paid Rs. 2,50,000 over and above his amounts due towards capital and profits. The calculation of Rs. 2,50,000 is based on market valuation of net assets of partnership firm. He seeks your advice, whether the amount of Rs. 2,50,000 is liable for capital gain?

[Source:- CIT v. R. Lingmallu Raghukumar [2002] 124 Taxman 127 (SC).]

Solution

Supreme Court in the above case made following observation:

"Where a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts in the manner prescribed by the relevant provisions of the partnership law there is no element of transfer of interest in the partnership assets by the retired partner to the continuing partners."

Considering the above, amount of Rs. 2,50,000 is not liable for capital gain.

Readers Note:

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(3) Section 2(42A): Types of Capital Assets

Case Study 8

Mr. Vimal Chand purchased a plot of land in 2003 Rs.2,00,000. He constructed building just two years back. Construction cost of building is Rs. 20,00,000. Recently, he sold the entire property consisting of plot and building for Rs. 35,00,000. Mr. Vimal Chand seeks your opinion on the nature of capital gain arising to him from the sale of the property. Computation of capital gain is not necessary.

[Source:-

CIT v. Vimal Chand Golecha (1993) 201 ITR 442 (Raj)

CIT v. Dr. D. L. Ramachandra Rao (1999) 236 ITR 51 (Mad)

CIT v. C.R. Subramanian (2000) 242 ITR 342 (Kar)]

Solution

Rajsthan High Court in case of CIT v. Vimal Chand Golecha had made following observations:

"The land is a capital asset in terms of s. 2(14) and in accordance with the scheme of the Act it is stated as a separate asset. Even for the purpose of s. 32 building which is entitled for depreciation would mean only the superstructure and would not include the site. If the price of two capital assets has been charged as one consolidated figure the assessee is entitled to bifurcate the same."

Considering the above, plot of land shall be considered as long term capital asset while construction shall be taken as short term capital asset.

Readers Note:

Case Study 9

Smt. Rama Rani Kalia purchased a leasehold property on July 7, 1984. Such leasehold rights in the property were converted into freehold rights on March 29, 2004. She sold the property on March 31, 2004 and declared long-term capital gains on the transfer. The Assessing Officer opined that since the property was acquired by converting the leasehold right into freehold right on March 29, 2004, and was sold within three days on March 31, 2004, the resultant capital gains would be short-term. Whether the view taken by assessing officer is correct?

[Source: CIT v. Rama Rani Kalia 358 ITR 499 (All)]

Solution

The High Court of Allahabad in case of CIT v. Rama Rani Kalia 358 ITR 499 held that that conversion of the rights of the lessee from leasehold to freehold is only by way of improvement of her rights over the property, which she enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period over which the property is held. Since, in this case, the period of holding is more than 36 months, the resultant capital gains would be long-term.

Considering the above, view taken by assessing officer is not correct

Readers Note:

Case Study 10

Mr. P. P. Menon was a partner in a firm which owned a hospital building and land. The firm was dissolved and the entire assets including the hospital building and land were taken over by the assessee. The assessee sold the hospital building and the land within three days of dissolution. He, however, claimed that the period of holding should be reckoned by including the period when he was a partner of the firm. He contended that since the total period has more than 36 months, the capital gain was to be treated as a long-term capital gain. Whether claim made by Mr. P.P. Menon is correct?

[Source: P.P. Menon V. CIT 325 ITR 122 (Ker)]

Solution

The Kerala High court in case of P.P. Menon V. CIT 325 ITR 122 held that the benefit of including the period of holding of the previous owner under section 2(42A) read with section 49(1)(iii)(b) can be availed only if the dissolution of the firm had taken place at any time before April 1, 1987.

In this case, the firm was dissolved on April 15, 2001 and therefore the benefit of these sections would not be available to the assessee.

Therefore, in this case, the period of holding of the asset received by the assessee-partner on dissolution of the firm has to be reckoned only from the date of dissolution of the firm. Since the assessee-partner has sold the property within three days of acquiring the same, **the gains have to be treated as short-term capital gain.**

Readers Note:

Case Study 11

Mr. Navin Jindal is holding shares of a company since 20 years. As a result, he was offered additional shares (right shares) to be subscribed at a concessional amount. Mr. Navin, instead of subscribing the same, renounced this right offer within 15 days and earned a surplus. He claims that such surplus is treated as long term capital gain since right which he renounced is a long term capital asset. Whether claim made by Mr. Navin Jindal is correct?

[Source: Navin Jindal v. ACIT 320 ITR 708 (SC)]

Solution

Supreme Court in case of Navin Jindal v. ACIT 320 ITR 708 held that for determining whether the capital gains on renunciation of right to subscribe for additional shares is short-term or long-term, the period of holding would be from the date on which such right to subscribe for additional shares comes into existence upto the date of renunciation of such right.

Considering the same, claim made by Mr. Navin is not correct.

Readers Note:

(4) Section 48: Mode of computation of capital gains

Case Study 12

Aruna Chalam inherits a house property from her father, who had mortgaged it. Thereafter she discharges the mortgages the debt and sells the property. Can she claim the amount paid to the mortgagee as cost of acquisition in computing the capital gain?

[Source: - RM Aruna Chalam v. CIT [1997] 227 ITR 222 (SC)]

Solution

The summary of observation made by Supreme Court in the above case is as under:

It has been held that where a mortgage was created by the previous owner during his time and the same was subsisting on the date of his death, the successor obtains only the mortgagor's interest in the property and by discharging the mortgage debt he acquires the mortgagee's interest in the property and, therefore, the amount paid to clear off the mortgage is the cost of acquisition of the mortgagee's interest in the property which is deductible as cost of acquisition under s. 48 of the Act.

Considering the above, claim made by Aruna Chalam is correct.

Readers Note:

Case Study 13

Mr. Jagadish Chandran mortgaged his house property and utilized the mortgage amount to perform the marriage of his son. He paid the amount to the mortgagee later. Upon sale of the said property thereafter, he claims the mortgage debt discharged as forming part of the cost of acquisition. Can capital gain be computed accepting his claim?

[Source:- V.S.M.R. Jagadish Chandran (Decd) v. CIT [1997] 227 ITR 240 (SC).]

Solution

Supreme Court while dealing with above matter made following observation:

In the present case, we find that the mortgage was created by the assessee himself. It is not a case where the property had been mortgaged by the previous owner and the assessee had acquired only the mortgagor's interest in the property mortgaged and by clearing the same he had acquired the interest of the mortgagee in the said property.

Considering the above, claim made by Mr. Jagadish Chandran is not acceptable.

Readers Note:

Case Study 14

Ms. Manjula shah sold out inherited property. While computing capital gain, she wants to claim-

(a) Cost to previous owner as cost of acquisition and

(b) Indexation from the date when previous owner acquired the property

Examine the validity of above claims made by Ms. Manjula.

[Source: - CIT v. Manjula J. Shah 204 Taxman 691 (Bom.)]

Solution

Bombay High court made following observation:

The object of giving relief to an assessee by allowing indexation is with a view to offset the effect of inflation. As per the CBDT Circular No. 636 dt. 31st Aug., 1992, a fair method of allowing relief by way of indexation is to link it to the period of holding the asset. The said circular further provides that the cost of acquisition and the cost of improvement have to be inflated to arrive at the indexed cost of acquisition and the indexed cost of improvement and then deduct the same from the sale consideration to arrive at the long-term capital gains. If indexation is linked to the period of holding the asset and in the case of an assessee covered under s. 49(1) of the Act, the period of holding the asset has to be determined by including the period for which the said asset was held by the previous owner, then

obviously in arriving at the indexation, the first year in which the said asset was held by the previous owner would be the first year for which the said asset was held by the assessee.

Considering the above, Ms. Manjula is entitled to claim indexation from the date when previous owner acquired the property.

Readers Note:

Case Study 15

Travencore Rubber & Tea Co. Ltd (TRTCL) entered into an agreement with Y for the sale of its property and received earnest money of Rs. 1,00,000. The balance of Rs. 4,00,000 was to be paid within 3 months, failing which TRTCL was entitled to a compensation of Rs. 50,000. The earnest money was also liable to be forfeited. Y defaulted in the payment of the balance within the time specified and, therefore, the earnest money was forfeited. A suit was also filed for breach of contract and Rs. 50,000 was awarded to TRTCL. Discuss the nature of the two receipts from the point of view of liability to tax.

[Source:- Travencore Rubber & Tea Co. Ltd v. CIT [2000] 109 Taxman 250 (SC).]

Solution

Relevant provision

Section 51:- Where any capital asset was on any previous occasion the subject of negotiations for its transfer, **any advance or other money received** and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition provided such advance or other money has been received on or before 31st March, 2014.

Supreme Court made following observation:

Thus, where there is a transfer of a capital asset, if there was a previous occasion when there were negotiations for its transfer, and if "advance or other money" had been received and retained by the assessee in respect of such negotiations, such amounts will in effect be added to the value of the capital asset impacting on the ultimate assessment of capital gains.

For this purpose, no distinction is made between moneys received and retained by way of 'advance' and 'other money'. The phrase 'other money' would cover, for example, deposits made by the purchaser for guaranteeing due performance of the contracts and not forming part of the consideration. The monies received on the previous occasions and retained by the vendor/assessee cannot therefore, be treated as a revenue receipt.

Considering the above, both receipts are not treated as revenue receipts.

Readers Note:

(5) Section 54 to 54GB: Exemptions from capital gains

Case Study 16

Mr. R. L. Sood is eligible to claim exemption under section 54. For this purpose, he had paid substantial amount towards purchase of residential house property to builder within four days from the date of transfer of old house. However, registration of documents as well as possession of new property has been given to him after two years. Income tax officer denies claim for exemption under section 54 on

the ground that purchase transaction is not completed within stipulated time period. Whether action of income tax officer is correct?

[Source: Commissioner Of Income Tax vs R.L. Sood 108 TAXMAN 227 (Delhi)]

Solution

Delhi High Court made following observation:

We may note that realising the practical difficulty faced by the assessee in such situations, the CBDT issued a Circular No. 471, dt. 15th Oct., 1986, clarifying that when the DDA issues the allotment letter to an allottee under its self-financing scheme, on payment of first instalment of cost of construction, the allottee gets title to the property and such allotment should be treated as cost of construction for the purpose of capital gains.

On the same analogy, the assessee having been allotted the flat, he having paid a substantial amount towards its cost within the stipulate period of one year, he cannot be denied the benefit of the said section because the flat purchased by him had come into his full domain within the period of two years, though the sale deed in his favour was registered subsequently.

Considering the above, action of assessing officer is not correct.

Readers Note:

Case Study 17

Arvinda Reddy, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the concerned previous year. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of Arvinda for a monetary consideration. He then utilized the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to this four brothers. Is Arvinda eligible for exemption under section 54 in respect of the long-term capital gain arising from the sale of his residential house, which he utilized for acquiring the shares of his brothers in the co-owned residential house? **[Source: CIT v. Aravinda Reddy [1979] 2 Taxman 541 (SC).]**

Solution

Supreme Court in the above case made following observation:

"We find no reason to divorce the ordinary meaning of the word "purchase" as buying for a price or equivalent of price by payment in kind or adjustment towards an old debt or for other monetary consideration from the legal meaning of that word in s. 54(1). "

Considering the above, Mr. Arvinda is eligible for exemption under section 54.

Readers Note:

Case Study 18

Mr. Kamal Vahal sold a capital asset and invested the sale proceeds in purchase of a new house in the name of his wife. He claimed exemption under section 54F in respect of the new residential house purchased by him in the name of his wife. However, the same was denied by the Assessing Officer on the ground that, in order to avail the benefit under section 54F, the investment in the residential house should be made by the assessee in his own name. Discuss validity of action taken by income tax officer.

[Source:- CIT v. Kamal Vahal 351 ITR 4 (Delhi)]

Solution

Delhi High Court has made following observation:

For the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name.

A similar view was upheld by this Court in *CIT v. Ravinder Kumar Arora (2012) 342 ITR 38,* where the new residential house was acquired in the joint names of the assessee and his wife and the Court had held that the assessee was entitled for 100% exemption under section 54F. In that case, it was further observed that section 54F does not require purchase of new residential house property in the name of the assesse himself. It only requires the assessee to purchase or construct a residential house.

Considering the above, action taken by income tax officer is not in accordance with law.

Readers Note:

Case Study 19

Sardarmal Kothari sold out Long term capital asset being diamonds. In order to avail exemption under section 54 F, he decided to construct residential house property for which he purchased plot of land and commenced construction. Entire sale consideration of diamonds was invested in purchase of plot. However, construction of residential property get completed after 3 years from the date of transfer of diamond. Assesssing Officer, relying on circular No. 667, dated 18-10-1993, denied exemption on the ground that construction is not completed within 3 years from the date of transfer. Whether action taken by A.O. is tenable in the eyes of law.

Source: CIT v. Sardarmal Kothari 217 CTR 414 (Mad.)

Solution

Madras High Court in the above case made following observation:

On a reading of the circular, we are of the view that the circular would not in any way advance the case of the Revenue to come to the conclusion that in order to have the benefit under s. 54F of the IT Act, the construction should have been completed.

Considering the above, action taken by assessing officer rejecting the claim of Section 54F is not tenable in the eyes of law.

Readers Note:

Case Study 20

Mr. Rajiv Shukla submits following information.

(i) Depreciated value of Block "Plant & Machinery" on 1st April, 2014:- Rs.10,00,000 (Block consisting of Plant A, Plant B and Plant C).

(ii) Purchase Plant D on 10th May, 2014 for Rs.2,00,000.

(iii) Sold out Plant A on 20th March, 2015 for Rs.17,00,000. (Plant A was purchased in June, 2004).

(iv) He purchased 1 BHK apartment for Rs. 18,50,000 on 10th April, 2015 and claimed exemption under section 54F.

Whether the claim of Rajiv Shukla for 54 F is correct?

[Source:- *CIT v. Rajiv Shukla (2011) 334 ITR 138 (Delhi)]*

Solution

Sec. 50 is a special provision where the mode of computation of capital gains is substituted if the assessee has claimed the depreciation on capital assets. Sec. 50 nowhere says that depreciated asset shall be treated as short-term asset, it only says that gain shall be deemed to be short term gain.

For determining nature of capital asset, one has to refer the definition of short term and long term capital asset. And as per these definitions, if asset is held for a period exceeding 36 months, same shall be treated as long term capital asset.

Considering the above, Delhi high court respectfully following the decision of Guahati High Court in case of CIT vs. Assam Petroleum Industries Ltd. 262 ITR 587, allowed the claim of Rajiv Shukla under section 54F.

Readers Note:

7 – INCOME FROM OTHER SOURCES

7.1 CHARGEABILITY UNDER THIS HEAD

Section:- 56(1)

Conditions to be observed to invoke this head are:-

(a) There must be an "income".

(b) Such income shall not be exempt under sections 10 to 13B.

(c) It is not chargeable to tax under earlier four heads of income.

7.2 SPECIFIED INCOMES WHICH SHALL BE CHARGEABLE UNDER THIS HEAD

Section:- 56(2)

Following incomes shall be chargeable to tax under the head "Income from other sources":

a. dividends;

b. any winnings from lotteries, crossword puzzles, races including horse-races, card games and other games of any sort or form, gambling or betting of any form or nature whatsoever ;

c. any sum received from employees as contribution to a fund for the welfare of employees if such income is not chargeable to tax under the head "Profits and gains of business or profession";

d. income by way of interest on securities if the income is not chargeable to tax under the head "Profits and gains of business or profession";

e. income from machinery, plant or furniture let on hire, if it is not chargeable to tax under the head "Profits and gains of business or profession";

f. income from letting of plant, machinery or furniture along with building and letting of building is inseparable from the letting of plant, machinery or building if it is not chargeable to tax under the head "Profits and gains of business or profession";

g. any sum received under a keyman insurance policy including bonus if not chargeable to tax under the head "Salary" or under the head "Profits and gains of business or profession"; and

h. any sum of money/properties received without consideration or properties received for a consideration which is less than fair market value or stamp duty, as the case may be.

i. interest received on compensation or on enhanced compensation.

j. Share premium in excess of fair market value in the hands of closely held company subject to fulfilment of certain conditions.

k. any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if,—

   (a) such sum is forfeited; and

   (b) the negotiations do not result in transfer of such capital asset.

On analysis of section 56 (2), following incomes <u>are always chargeable</u> under the head Income from other sources <u>even though these incomes are derived from regular activity.</u>

a. *dividends (even though derived from shares held as stock-in-trade)*

b. *any winnings from lotteries, crossword puzzles, races including horse-races, card games and other games of any sort or form, gambling or betting of any form or nature whatsoever;*

h. any sum of money/properties received without consideration or properties received for a consideration which is less than fair market value or stamp duty, as the case may be.

i. *interest received on compensation or on enhanced compensation*

j. Share premium in excess of fair market value in the hands of closely held company subject to fulfilment of certain conditions.

k. any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if,—

(a) such sum is forfeited; and

(b) (b) the negotiations do not result in transfer of such capital asset.

Practical 1

Mention the appropriate head of income under which following incomes are taxable?

(1) Income from letting out of building
(2) Income from letting out of vacant plot of land
(3) Income from subletting of building
(4) Sales commission received by an employee
(5) Sales commission received by an agent
(6) Remuneration received by Member of Parliament
(7) Sitting fee received by director who is not an employee of the company
(8) Salary received by a professor from college
(9) Remuneration received by a professor for checking papers from University
(10) Interest income from Fixed Deposit / Government Securities
(11) Annuity payable by an employer
(12) Annuity payable by an insurance company
(13) Pension received by an employee
(14) Family Pension received by family member of deceased employee
(15) Interest on employee's contribution to unrecognized provident fund

Solution

(1) Income from house property
(2) Income from other sources
(3) Income from other sources
(4) Income under the head "Salary"
(5) Income from other sources
(6) Income from other sources
(7) Income from other sources
(8) Income under the head "Salary"

(9) Income from other sources

(10) Income from other sources

(11) Income under the head "Salary"

(12) Income from other sources

(13) Income under the head "Salary"

(14) Income from other sources

(15) Income from other sources- **CIT v. G. Hyatt (1971) 80 ITR 177 (SC).**

Reader's Note:

7.3 METHOD OF ACCOUNTING

Sections:- 8, 145, 145A

- For this head, taxpayer can follow either Mercantile or Cash system. Hybrid method of accounting is not permissible. Further, taxpayer has to comply with the "Income Computation and disclosure standards" (ICDS) applicable to the class or classes of income governed by this head.
- However, taxability of dividend is governed by section 8 and not as per the method of accounting adopted by taxpayer.
- Further, as per section 145A, interest received on compensation or on enhanced compensation shall be taxed in the year of receipt and not as per the method of accounting adopted by taxpayer.

7.4 MEANING OF DIVIDEND

Sections:- 56(2)(i) and 2(22)(a) to 2(22)(e)

The concept of dividend under the Income Tax Act is very wide. Therefore, it has been divided into following paras for better understanding.

Para No.	Description
Para 7.4	Meaning of dividend
Para 7.4A	Few distributions are not treated as dividend
Para 7.4B	Meaning of accumulated profits
Para 7.4C	Specific deductions which can be claimed against dividend income
Para 7.4D	Tax treatment of dividend income in the hands of shareholder
Para 7.4E	Basis of charge of dividend income

Section 2(22) of the Income Tax Act defines term "dividend". This definition is inclusive one. It covers five sub clauses (a) to (e). Let us understand each clause one by one.

(3) Distribution of accumulated profits entailing (requiring / necessitating) release of company's assets [Section 2(22)(a)]

In order to be called dividend under this clause, following two conditions are required to be satisfied.

First Distribution by a company out of accumulated profits (whether capitalized or not) and

Second Such distribution entails release of the assets by the company to its shareholders.

Practical 2

Nirma Limited has an accumulated profit of Rs. 500 crores. During the concerned previous year, it passed a resolution to distribute its "Corporate House" among its shareholders. Book value of "Corporate House" was Rs. 2.5 crore while fair market value was Rs. 32 crore. Answer the following questions:-

(i) Whether such distribution amounts to deemed dividend?

(ii) If answer to question (i) is yes, then what is the amount of deemed dividend and who is liable to pay tax on such dividend?

Solution

(i) As per section 2(22)(a), any distribution by a company out of accumulated profits which results into release of asset in favour of shareholder amounts to dividend. Such distribution may be in the form of cash or in kind. – **Kantilal Manilal v. CIT [1961] 41 ITR 275 (SC).** Considering the same, distribution of "Corporate House" by Nirma Limited to its shareholders amounts to deemed dividend.

(ii) When assets are distributed as dividend, amount of dividend is taken to be the market value of the property on the date on which the shareholders become entitled to receive such dividend— **CIT v. Central India Industries Ltd. [1971] 82 ITR 555 (SC).** Therefore, in present case, amount of deemed dividend shall be Rs. 32 crore (being fair market value on the date of distribution).

As per section 115 O, domestic company is required to pay corporate dividend tax on every dividend distributed or paid except dividend under section 2(22)(e). Therefore, Nirma Limited is required to pay corporate dividend tax on such distribution.

Reader's Note:

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(4) Distribution of accumulated profits in the form of debentures, preference bonus shares etc. [Section 2(22)(b)]

This clause covers following two distributions to be treated as deemed dividend to the extent of accumulated profits (whether capitalized or not)-

a. Distribution by a company to its shareholders of
- debentures,
- debenture-stock or
- deposit certificates
- in any form, whether with or without interest; and

b. Distribution by a company to its preference shareholders of preference bonus shares.

Practical 3

Torrent power limited has an accumulated profit of Rs. 10,500 crores. During the concerned previous year, it wants to make following distributions to shareholders.

(i) Preference bonus shares to preference shareholders

(ii) Equity bonus shares to equity shareholders

(iii) Bonus debentures to equity / preference shareholders

Whether above distributions amounts to deemed dividend?

Solution

Tax treatment of various distribution made by Torrent Power Limited is as under:

Various Distributions to shareholders	Whether it is deemed dividend?	Under which clause? / Remark
(i) Preference bonus shares to preference shareholders	Yes	Section 2(22) (b)
(ii) Equity bonus shares to equity shareholders	No	Such distribution is not covered by section 2(22)(b). Further, such distribution does not entail release of company's assets. Therefore, it does not fall under section 2(22) (a) also.
(iii) Bonus debentures to equity / preference shareholders	Yes	Section 2(22)(b)

Reader's Note:

(5) Distribution of accumulated profits at the time of liquidation [Section 2(22)(c)]

Any distribution made to the shareholders of a company on its liquidation, to the extent to which distribution is attributable to the accumulated profits (whether capitalised or not) of the company immediately before its liquidation.

Readers here note that distribution to shareholders of a company on liquidation also results into transfer of capital asset and therefore such distribution attract head "Capital gain" also.

Therefore, amount received by a shareholder on liquidation needs to be bifurcated into:-

1. Deemed Dividend (IFOS) and
2. Capital recovery (Capital Gain)

While doing above bifurcation, following points merit consideration:-

(i) In case of a company, which is in liquidation, accumulated profits includes all profits of the company up to the date of liquidation. That means, any profits or loss arising as a result of liquidation are not a part of accumulated profits.

(ii) The distribution is deemed to take place in the ratio of accumulated profits and share capital. - **CIT v. Girdhardas& Co. (P.) Ltd. [1967] 63 ITR 300 (SC).**

(iii) **Ceiling:-** Further, deemed dividend has to be restricted to the extent of share of shareholder in accumulated profits and balance amount is towards capital recovery.

Practical 4

Mr. Sunil purchased 4000 Equity shares in Parivartan Education Private Ltd on June 20, 2001 at the rate of Rs. 2 Per Share. Parivartan Education Private Ltd goes into liquidation on **April 30, 2017**. The Balance Sheet of the company as on **April 30, 2017** is as follows:

Liabilities	**Rs.**	**Assets**	**Rs.**
40000 Equity Shares	4,00,000	Fixed Assets	28,00,000
Reserve and Surplus	30,00,000	Cash and Bank	12,08,550
Current Liabilities	6,0,8550		
	40,08,550		**40,08,550**

On liquidation, the assets are distributed proportionately among shareholders. Discuss tax consequences in the hands of Mr. Sunil under following alternatives assuming that current liabilities are inclusive of appropriate corporate dividend tax liability of the company.

Alternative (a): Fair market value of Fixed Assets is Rs. 28,00,000
Alternative (b): Fair market value of Fixed Assets is Rs. 11,00,000
Alternative (c): Fair market value of Fixed Assets is Rs. 62,00,000

Solution

Alternative (a)

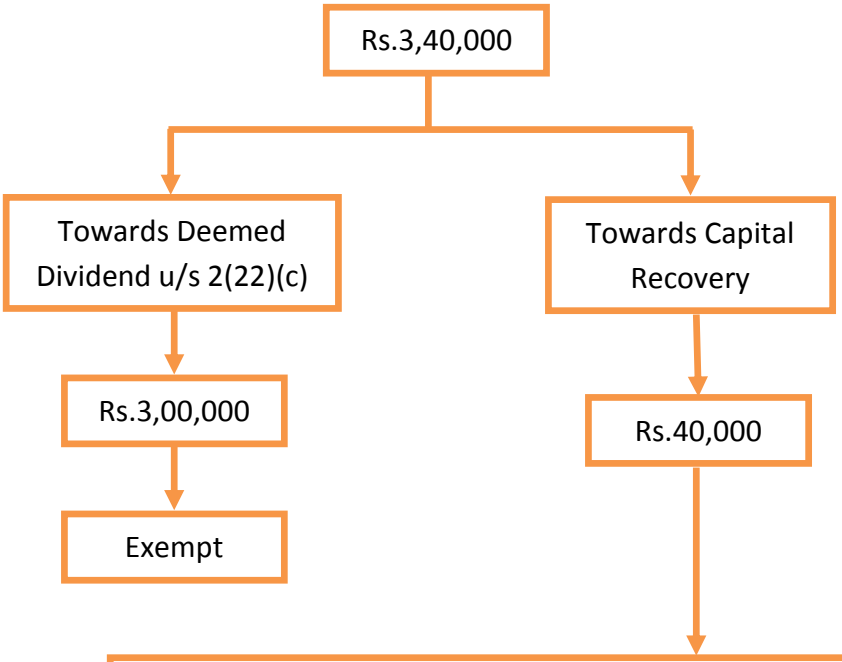
Total funds / Assets available with Parivartan Education Private Limited for distribution to its shareholders:

Particulars	**Rs.**
Fixed Assets (M.V.)	28,00,000
Cash and Bank Balance	12,08,550
Sub-Total	**40,08,550**
Less: Amount used for meeting Current Liabilities	(6,08,850)
Total Funds available for distribution to shareholders	**34,00,000**

Out of Rs. 34,00,000, Mr. Sunil will receive $1/10^{th}$ share i.e. Rs. 3,40,000.

As discussed earlier, the distribution is deemed to take place in the ratio of accumulated profits and share capital. - **CIT v. Girdhardas& Co. (P.) Ltd. [1967] 63 ITR 300 (SC).**

Considering the above, tax treatment of Rs. 3,40,000 in the hands of Sunil is as under:



Computation of Capital Gain

Period of Holding: June 2001 to April 2017
Nature of Capital Asset: Long Term

Particulars	(Rs.)
Full value of consideration	40,000
Less: Expenses in connection with Transfer	-
Net Consideration	40,000
Less: Cost of acquisition $\left(8{,}000 \times \frac{272}{100}\right)$	(21,760)
Long Term Capital Gain	**18,240**

Alternative (b)

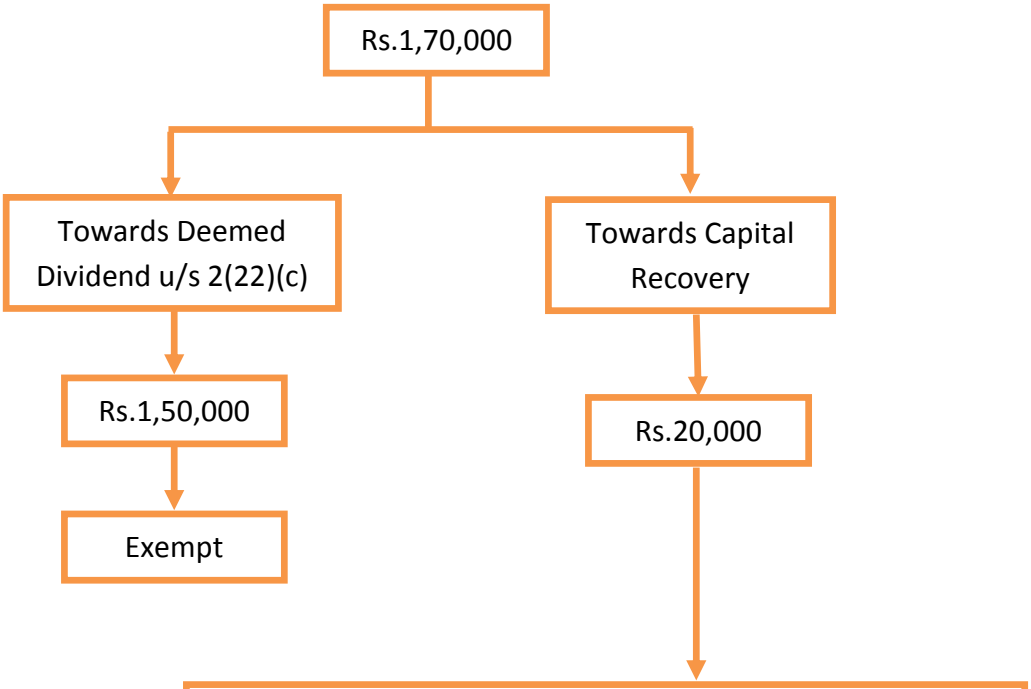
Total funds / Assets available with Parivartan Education Private Limited for distribution to its shareholders:

Particulars	Rs.
Fixed Assets (M.V.)	11,00,000
Cash and Bank Balance	12,08,550
Sub-Total	**23,08,550**
Less: Amount used for meeting Current Liabilities	(6,08,850)
Total Funds available for distribution to shareholders	**17,00,000**

Out of Rs. 17,00,000, Mr. Sunil will receive 1/10th share i.e. Rs. 1,70,000.

As discussed earlier, the distribution is deemed to take place in the ratio of accumulated profits and share capital. - **CIT v. Girdhardas& Co. (P.) Ltd. [1967] 63 ITR 300 (SC).**

Considering the above, tax treatment of Rs. 1,70,000 in the hands of Sunil is as under:



Computation of Capital Gain

Period of Holding: June 2001 to April 2017 Nature of Capital Asset: Long Term	
Particulars	**(Rs.)**
Full value of consideration	20,000
Less: Expenses in connection with Transfer	-
Net Consideration	20,000
Less: Cost of acquisition $\left(8{,}000 \times \frac{272}{100}\right)$	(21,760)
Long Term Capital Loss	**1,760**

Alternative (c)

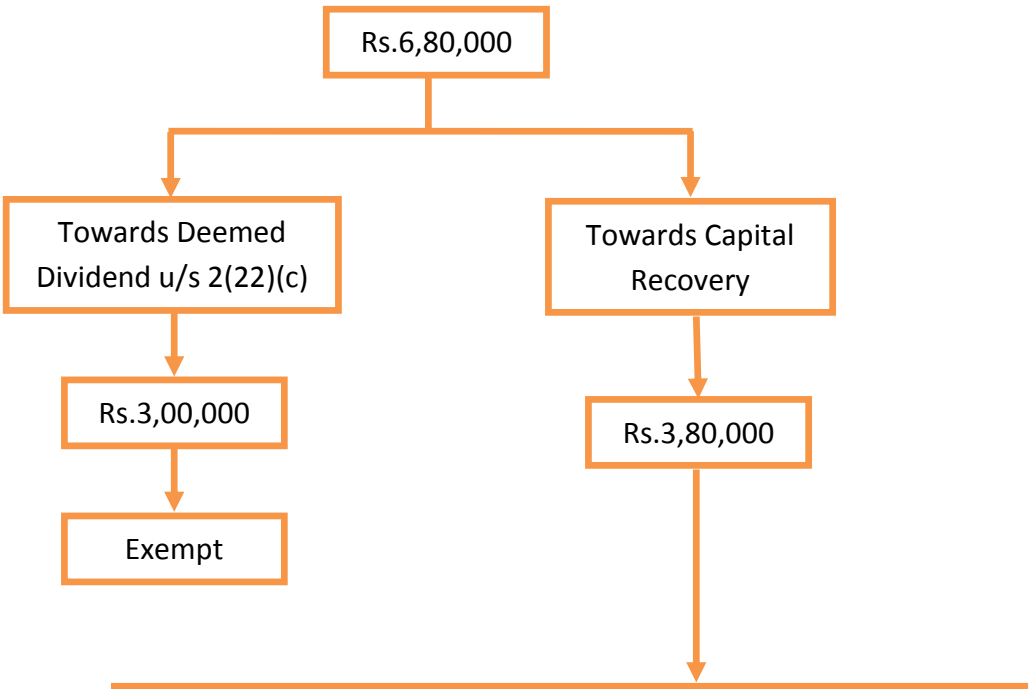
Total funds / Assets available with Parivartan Education Private Limited for distribution to its shareholders:

Particulars	**Rs.**
Fixed Assets (M.V.)	62,00,000
Cash and Bank Balance	12,08,550
Sub-Total	**74,08,550**
Less: Amount used for meeting Current Liabilities	(6,08,850)
Total Funds available for distribution to shareholders	**68,00,000**

Out of Rs. 68,00,000, Mr. Sunil will receive 1/10th share i.e. Rs. 6,80,000.

In this case, deemed dividend shall be restricted to the extent of share of Mr. Sunil in Accumulated Profits and balance shall be towards capital recovery.

Considering the above, tax treatment of Rs. 6,80,000 in the hands of Sunil is as under:



Computation of Capital Gain

Period of Holding: June 2001 to April 2017.
Nature of Capital Asset: Long Term

Particulars	(Rs.)
Full value of consideration	3,80,000
Less: Expenses in connection with Transfer	-
Net Consideration	3,80,000
Less: Cost of acquisition $\left(8{,}000 \times \frac{272}{100}\right)$	(21,760)
Long Term Capital Gain	**3,58,240**

Summary:

Alternative	Equation	Manner of appropriation
(a)	TF = AP + SC	Ratio of AP and SC
(b)	TF <AP + SC	Ratio of AP and SC
(c)	TF > AP + SC	Restrict deemed dividend to the extent of share in AP and balance shall be towards capital recovery

Reader's Note:

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(6) Distribution of accumulated profits on the reduction of capital [Section 2(22)(d)]

Any distribution made to shareholders of the company on the reduction of capital is treated as dividend to the extent the company possesses accumulated profits (whether capitalized or not).

Let's do analysis of this clause.

Capital reduction takes place in two situations:

Situation I :- When company is incurring huge losses and having liabilities more than the recoverable value of assets. In this event, management may, subject to the provisions of Companies Act, opt for capital reduction together with compromise with creditors.

In this situation, question of deemed dividend in the hands of shareholders does not arise as company does not have accumulated profits.

Situation II :- When company is having huge reserve and surplus and management decides for buy back of shares in accordance with provisions of Companies Act.

In this situation, there is an accumulated profits in the hands of company and therefore distribution at the time buy back of shares may result into deemed dividend in the hands of shareholders but with effect from the assessment year 2000-01, any payment made by a company on purchase of its own shares (Buy Back of shares) in accordance with the provisions contained in section 77A of the Companies Act does not amount to deemed dividend.

Readers must note that capital reduction results into transfer of capital assets and therefore, it envisages computation gain or loss under the head "Capital Gain".

(7) Payment by way of loan or advance to a shareholder / concern. [Section 2(22)(e)]

Under this clause, following two types of transactions are covered:

(i) loan or advance to a shareholder to the extent company possesses accumulated profits.

(ii) loan or advance to a concern to the extent company possesses accumulated profits.

(A) Loan or advance to a shareholder - Loan or advance to a shareholder is treated as dividend in the hands of shareholder if the following conditions are satisfied:

a. loan or advance is given by a company in which the public are not substantially interested (closely held company);
b. loan or advance is given to a shareholder (being a person who is a registered shareholder as well as the beneficial owner of at least 10 per cent equity shares);
c. the company must possess accumulated profits (excluding capitalized profits) at the time of granting loan or advance.

Remark: Section 2(22)(e) is applicable even if loan is given in kind—**M.D. Jindal v. CIT [1986] 28 Taxman 509 (Cal.).**

Practical 5

Ding Dong Pvt. Ltd has an accumulated profit of Rs.50 lacs. During the concerned previous year, it advanced Rs.35 lacs to Mr. Ajit. Discuss tax consequences of this transaction under following alternatives:

Alternative (a) Mr. Ajit is a registered as well as beneficial shareholder of Ding Dong Pvt. Ltd. holding 8% equity shares.

Alternative (b) Mr. Ajit is a registered as well as beneficial shareholder of Ding Dong Pvt. Ltd. holding 12% equity shares.

Alternative (c) Mr. Ajit is only a beneficial shareholder of Ding Dong Pvt. Ltd. holding 12% equity shares (Mr. Mohit is the registered shareholder of these 12% holding)

Alternative (d) Mr. Ajit is a registered as well as beneficial shareholder of Ding Dong Pvt. Ltd. holding 12% preference shares and does not hold any equity shares.

Also discuss tax consequences for alternative (b) assuming that accumulated profit of the company is Rs. 22 lacs.

Solution

Alternative (a):

Since equity shareholding of Mr. Ajit is only 8% (not 10%), loan of Rs. 35 lacs advanced by Ding Dong Pvt. Ltd. is not treated as deemed dividend under section 2(22)(e).

Alternative (b):

Since all the requirements of section 2(22)(e) are satisfied, entire loan of Rs. 35 lacs advanced by Ding Dong Pvt. Ltd. is treated as deemed dividend in the hands of Mr. Ajit.

It is important to note here that entire loan (and not the share of Mr. Ajit in Accumulated Profit) shall be treated as deemed dividend. Gujarat High Court in case of **CIT v. Mayur Madhukant Mehta [1972] 85 ITR 230 (Guj) & CIT v. BhagwatTewari [1976] 105 ITR 62 (Cal.)** observed that there is nothing in section 2(22)(e) to restrict the deemed dividend to that portion of accumulated profits which corresponds to the assessee's shareholding in the capital of the company.

Alternative (c):

First view

Supreme Court in case of **Rameshwarlal Sanwarmal V. CIT (1980) 3 Taxmann 1** observed that for section 2 (22) (e), the word "shareholder" means the registered as well as beneficial owner of a share.

In present case, Mr. Ajit is only a registered shareholder while Mr. Mohit is a beneficial shareholder, therefore, the amount of loan advanced to Mr. Ajit is not treated as deemed dividend.

Second view

Delhi High Court in case of **CIT v. National Travel Services (2012) 347 ITR 305** has observed that the essential condition to be satisfied is that of beneficial ownership and it is not necessary that beneficial owner has to be a registered owner.

If this view has been adopted then the amount of loan advanced to Mr. Ajit is treated as deemed dividend.

Alternative (d):

Provisions of section 2(22)(e) shall be attracted only when the shareholder holds 10% equity shares of a closely held company. In the present case, Mr. Ajit does not hold equity shares, therefore, the amount loan advanced to him is not treated as deemed dividend.

Modified alternative (b):

Since accumulated profit is Rs. 22 lacs while loand advanced is Rs. 35 lacs, the amount of deemed dividend under section 2(22) (e) shall be restricted to the available accumulated profits i.e. Rs. 22 lacs.

Reader's Note:

Practical 6

Timex Private Limited has three major shareholders namely Mr. X (who holds 10% equity), Mr. Y (who holds 12% equity) and Mr. Z (who holds 18% equity). As on **01-04-2017**, the company has an accumulated profit of Rs. 20 lacs. During the previous year, Timex Private Limited has granted various loans to these shareholders. Details of these loans are as under:

Name of Shareholder	Date of loan	Amount of loan
Mr. X	01-04-**2017**	Rs. 10 lacs
Mr. Y	01-07-**2017**	Rs. 12 lacs
Mr. Z	01-10-**2017**	Rs. 18 lacs

Discuss tax consequences of above transaction assuming that Timex Private Limited has earned profit of Rs. 5 lac and Rs. 3 lac in first and second quarter respectively.

Also discuss tax consequences assuming that all the loans were repaid by Mr. X, Mr. Y and Mr. Z together with interest before the end of previous year.

Solution

Tax Treatment in the hand of Mr. X

Date of Loan	01-04-**2017**
Accumulated Profits on the date of loan	Rs. 20 lacs
Amount of Loan	Rs. 10 lacs
Is entire loan amount covered by the accumulated profits on the date of loan?	Yes
The amount of deemed dividend taxable in the hands of Mr. X	Rs. 10 lacs

Tax Treatment in the hand of Mr. Y

Date of Loan	01-07-**2017**
Accumulated Profits on the date of loan	

	Rs. in lacs
Accumulated Profits as on 01-04-**2017**	20
Add: Profit of the first quarter **(Refer Note 1)**	5
Sub total	25
Less: Amount of deemed divided already taxed in the hands of Mr. X **(Refer Note 2)**	10
Accumulated Profit as on 01-7-2017	**15**

	Note 1: As per explanation to section 2(22), in case of a company which is not in liquidation, accumulated profits include all profits upto the date of distribution or payment. **Note 2:** In case of **CIT v. G. Narasimhan [1999] 102 Taxman 66,** Supreme Court observed that for the purpose of section 2(22) (e), accumulated profits get reduced by the amount deemed already taxed even if no adjustment is made in the books of account.
Amount of Loan	Rs. 12 lacs
Is entire loan amount covered by the accumulated profits on the date of loan?	Yes
The amount of deemed dividend taxable in the hands of Mr. Y	Rs. 12 lacs

Tax Treatment in the hand of Mr. Z

Date of Loan	01-10-**2017**
Accumulated Profits on the date of loan	

	Rs. in lacs
Accumulated Profits as on 01-07-**2017**	15
Add: Profit of the second quarter	3
Sub total	18
Less: Amount of deemed divided already taxed in the hands of Mr. Y	12
Accumulated Profit as on 01-10-2017	**6**

Amount of Loan	Rs. 18 lacs
Is entire loan amount covered by the accumulated profits on the date of loan?	No
The amount of deemed dividend taxable in the hands of Mr. Z	Since accumulated profits on the date of loan is Rs. 6 lacs while loan advanced is Rs. 18 lacs, the taxable dividend is restricted upto Rs. 6 lacs in the hands of Mr. Z.

Since the liability is attracted at the moment the loan is given to the shareholder, section 2(22)(e) is applicable even if loan is repaid before the end of the previous year. **Tarulata Shyam v. CIT [1977] 108 ITR 345 (SC).**

Reader's Note:

Readers must note that section 2(22) (e) covers following payments:-

a. any payment by way of advance or loan to a shareholder;

b. any payment on behalf of a shareholder; or

c. any payment for the benefit of a shareholder.

Practical 7

Mr. Chettiar, managing director of Cubic Private Limited, holds 70 percent of its paid up capital. The balance as at March 31, **2017** in general reserve is Rs.6 lakh. The company, during the previous year, has given an interest-free loan Rs.5 lakh to its supervisor having salary of Rs.4,000 per month, who in turn advances the said amount of loan so taken from the company to Mr. Chettiar. The Assessing Officer wants to tax the amount of advance in the hands of Mr. Chettiar. Is the action of Assessing Officer correct?

Solution

In the present case, loan is given to supervisor for the benefit of Mr. Chettiar, therefore, such loan is treated as deemed dividend under section 2(22)(e) in the hands of **Mr. Chettiar.-L. Alagusundaram Chettiar v. CIT [2002] 121 Taxman 587 (SC).**

Reader's Note:

(B) Loan or advance to a concern:- Loan or advance to a concern is treated as a deemed dividend in the hands of the shareholder if the following conditions are satisfied:

a. loan or advance is given by a company in which the public are not substantially interested (closely held company) to a concern;
b. there is a shareholder (being a person who is a registered shareholder as well as the beneficial owner) who holds 10 percent equity share capital in the above mentioned company;
c. the abovementioned shareholder also have substantial interest in such concern;
d. the company must possess accumulated profit (excluding capitalized profits) at the time of granting loan or advance.

Substantial Interest: A person, shall be deemed to have a substantial interest in a concern, if he is at any time during the previous year, beneficially entitled to at least 20 per cent of income of such concern.

Similarly, a person, shall be deemed to have a substantial interest in a company, if he is the beneficial owner of at least 20 per cent equity share capital of that company.

Concept of Registered owner Vs. Beneficial owner | Concept of Substantial interest

Mr. Chandragupt Mourya has subscribed 20 percent equity shares of Chankya Education Limited in the name of his son.

Then, in this case, son is called "a registered shareholder "while Mr. Chandragupt Mourya is called "a beneficial owner of shares".

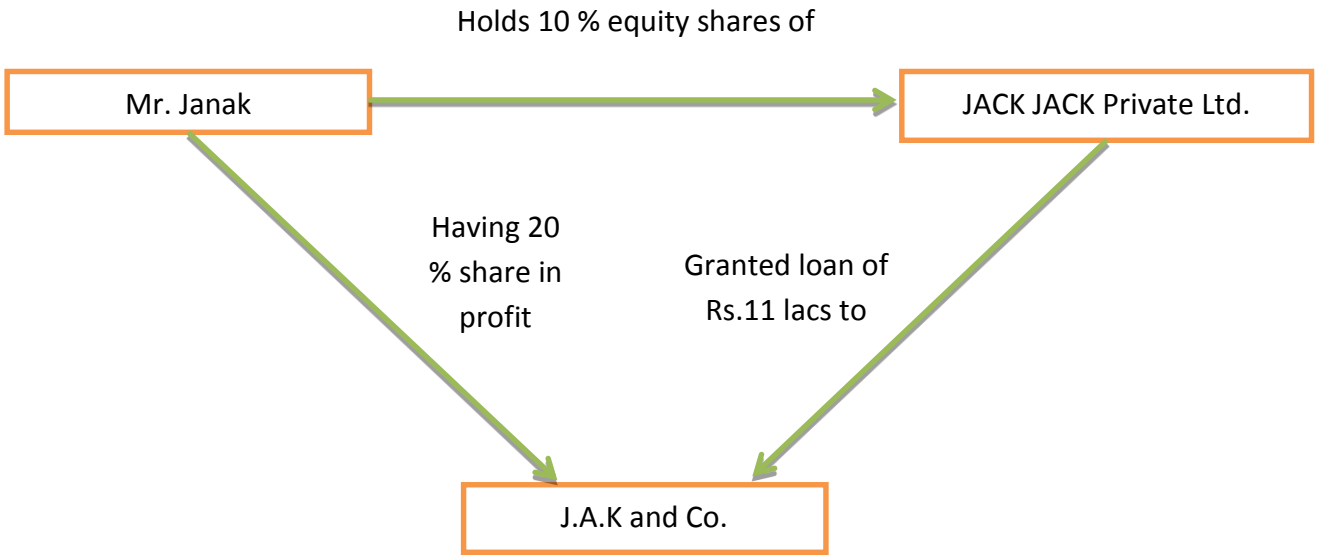
Further, Mr. Chandragupt Mourya is said to have substantial interest in Chankya Education private limited even though he does not hold single share in his name.

On the other hand, son is not said to have substantial interest in Chankya Education private limited even though he holds 20 percent equity shares in his name

Practical 8

Mr. Janak holds 10% equity shares of JACK JACK Private Limited. He is also a partner in "J. A. K and co." having 20% share in profit. The JACK JACK Private Limited possesses accumulated profit of Rs. 56 lac. During the previous year, JACK JACK Private Limited has granted loan of Rs. 11 lac to "J.A.K and co." Discuss tax consequences of this transaction.

Solution



(i) Mr. Janak is a shareholder of JACK JACK Private Ltd holding 10% equity shares.

(ii) Mr. Janak is also having 20% share in profit of J.A.K and Co. (i.e. he has substantial interest in J.A.K. and Co.

(iii) JACK JACK Private Ltd. granted loan of Rs.11 lacs to concern J.A.K and Co. in which Mr. Janak has substantial interest.

(iv) Applying the ratio laid down in case of **CIT v. Hotel Hilltop 313 ITR 116 (Raj.) , CIT v. Rajkumarsingh 295 ITR 9 (Allahabad)**, whenever loan is given to a concern in which shareholder (holding 10% voting power) of closely held company has substantial interest then such loan is deemed as dividend in the hands of shareholder (Mr. Janak) and not in the hands of that concern(J.A.K. and co.) particularly when concern is not a shareholder.

(v) Therefore, amount of Rs.11 lacs shall be taxed in the hands of Mr. Janak as deemed dividend under section 2(22)(e).

Reader's Note:

7.4A FEW DISTRIBUTIONS ARE NOT TREATED AS DIVIDEND

Section:- 2(22)

(1) Any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act,1956

(2) Any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.

(3) For the purpose of section 2(22) (c) and 2(22) (d), the following are not treated as dividend:

a. any distribution to preference shareholders when preference shares are issued for full cash consideration; and

b. any distribution to equity shareholders in respect of bonus shares allotted to them after March 31, 1964, but before April 1, 1965.

(4) For the purpose of Section 2(22)(e), following payments are, however, not treated as dividend:

a. Any advance or loan made to a shareholder or a concern by a company in the ordinary course of its business, where money-lending is a substantial part of the business of the company. and

b. 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 section 2(22)(e).

Practical 9

X private limited provides the following information:-

Paid up share capital	Rs. 10 crores
Accumulated profits	Rs. 2.60 crores
Loan given to Mr. A (who holds 10% equity)	Rs. 30 lakhs

The loan is still outstanding and subsequently company declared regular dividend @10%. Discuss tax consequences in the hands of company in following alternatives:

(a) Company set off regular dividend payable to Mr. A against loan outstanding.

(b) Company had distributed regular dividend to Mr. A without being set off against loan outstanding.

Solution

Alternative (a): Considering the exception to section 2(22)(e), the amount of loan so set off shall not be considered as dividend therefore, the amount of dividend to be distributed by the company shall be Rs. 90 lakh (Rs. 1 crore less Rs. 10 lacs). Therefore, X private limited is required to pay corporate dividend tax under section 115 O on Rs. 90 lacs.

Alternative (b): In this alternative, the amount distributed by X Private Limited is Rs. 1 crore which is subject to corporate dividend tax under section 115 O.

Reader's Note:

7.4B MEANING OF ACCUMULATED PROFITS

Section:- Explanation 1 and 2 of section 2(22)

(a) An accumulated profit does not include capital gains arising before April 1, 1946 and after March 31, 1948 but before April 1, 1956.

(b) In case of a company, which is not in liquidation, it includes all profits of a company up to the date of distribution or payment.

(c) In case of a company, which is in liquidation, it includes all profits of the company up to the date of liquidation.

(d) In case of company, which is in liquidation consequent on the compulsory acquisition of a company's undertaking by the Government or a corporation owned or controlled by the Government, then accumulated profits do not include any profits of the company prior to the three successive years immediately preceding the previous year in which such acquisition took place.

(A) Based on decisions of courts, Accumulated profit <u>includes:</u>

a. Balance of Profit and loss account
b. Current Profit
c. General Reserve
d. Development Rebate Reserve
e. Investment Allowance Reserve
f. Any other free Reserve e.g. Building Reserve Fund
g. Additions made by Assessing Officer on account of concealed income
h. Exempt Incomes
i. Capital Gain chargeable to tax

(B) Based on decisions of courts, Accumulated Profit does not include:

a. Balancing Charge computed under section 41(2)
b. Capital Gain not chargeable to tax
c. Additions made by Assessing Officer in respect of inadmissible expenses
d. Depreciation Reserve / Fund
e. Provisions for taxation
f. Proposed Dividend

Note: - For determining accumulated profits, depreciation as per Income tax Act has to be considered.

Practical 10

XYZ Ltd. is a company registered in India. The balance sheet of the company on March 31, **2018** is as under:

Liabilities	*Rs.*	*Assets*	*Rs.*
Preference share capital (issued for cash)	4,00,000	Fixed assets (before depreciation)	15,00,000
		Investment in share (market value Rs. 13,00,000)	4,00,000
Equity share capital			
- issued for cash	6,00,000	Other assets	9,20,000
- issued as bonus shares in 1960 and 1976 by capitalising profits	6,00,000		
General reserve	3,00,000		
Investment allowance reserve	90,000		
Depreciation reserve	1,00,000		
P & L A/c balance as on April 1, **2017**: Rs.2,40,000			
Add**:** Profit of the year ending March 31, **2018** Rs. 60,000	3,00,000		
Provision for taxation and dividend	2,30,000		
Current liabilities	2,00,000		
	28,20,000		**28,20,000**

Note: Profit and loss account balance on April 1, **2017** includes agricultural income of Rs.30,000.

You are required to ascertain the accumulated profits of the company to apply the deeming fiction of Section 2(22).

Solution

Computation of accumulated profits for the purpose of section 2(22) (a) to (d)

Particulars	**Rs.**
General Reserve	3,00,000
Investment allowance reserve	90,000
Profit and Loss Account	3,00,000
Bonus shares (Capitalized profits)	6,00,000
Total Accumulated Profits	**12,90,000**

Computation of accumulated profits for the purpose of section 2(22)(e)

Particulars	Rs.
General Reserve	3,00,000
Investment allowance reserve	90,000
Profit and Loss Account	3,00,000
Bonus shares (Capitalized profits)	Nil **(Refer note)**
Total Accumulated Profits	**6,90,000**

Note: Accumulated profits for the purpose of section 2(22)(e) excludes capitalized profits.

Reader's Note:

7.4C SPECIFIC DEDUCTIONS THAT CAN BE CLAIMED AGAINST DIVIDEND INCOME

Section:- 57(i)

Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising dividend, is deductible.

However, no deduction shall be allowed from dividend income which is exempt from tax.

7.4D TAX TREATMENT OF DIVIDEND INCOME IN THE HANDS OF SHAREHOLDER

Section:- 115-O, 10(34), 115BBDA

Before, we understand tax treatment in the hands of shareholders, readers shall consider section 115-O.

Reference of Sec. 115-O – Corporate Dividend Tax / Dividend Distribution Tax

1. Only domestic company is liable for a tax on distributed profit.
2. Any amount declared, distributed or paid by a domestic company by way of dividend shall be charged to dividend tax.
3. Section 115-O is applicable to all types of dividend except dividend covered under section 2(22)(e).
4. Tax rate is 15 % (+Surcharge) which is further increased by education cess.

(A) Dividend received from a Domestic Company

If dividend is covered by section 2(22) [Except section 2(22)(e)] then it is not taxable in the hands of shareholders by virtue of section 10(34). The reason for exemption is that on such dividend the company declaring dividend will have to pay dividend tax under section 115-O.

The exemption under section 10(34) is available for those dividends on which company has paid corporate dividend tax under section 115- O. And section 115-O is not applicable to the dividends covered by section 2(22)(e). As a result, loan or advance which is treated as deemed dividend under section 2(22)(e) is taxable in the hands of shareholder.

The exemption under section 10(34) is subject to provisions of section 115BBDA. Section 115BBDA provides that aggregate dividend in excess of Rs. 10 lakh shall be chargeable to tax in the case of an individual, Hindu undivided family (HUF) or a firm who is resident in India, at the flat rate of 10% without being any deduction in respect of any expenditure or allowance or set –off of loss.

(B) Dividend received from a non-domestic company (Foreign Company)

The exemption under section 10(34) is available for those dividends on which company has paid corporate dividend tax under section 115- O. And section 115-O is not applicable to foreign company. As a result, dividend received from a foreign company is chargeable to tax in the hands of shareholder.

7.4E BASIS OF CHARGE OF DIVIDEND INCOME

Section:- 8

Section 8 decides the year in which dividend is taxable therefore, method of accounting adopted by taxpayer has no relevance.

(A) Regular dividend

Regular dividend declared is deemed to be the income of the previous year in which it is declared.

(B) Deemed dividend

Deemed dividend under section 2(22) is treated as the income of the previous year in which it is so distributed or paid.

(C) Interim dividend

Interim dividend is deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available to a shareholder.

Practical 11

Discuss the year of taxability in respect of followings assuming that Mr. Bhishma follows mercantile method of accounting.

1. Mr. Bhishma received dividend of Rs. 10,200 from Lanka Limited, a foreign company. Date of receipt was 04-04-**2017** though it was declared by Lanka Limited on 21-03-**2017**.
2. Zakkas private limited possesses accumulated profit of Rs. 50 lakhs, has granted loan of Rs. 12 lac to Mr. Bhisma (who holds 10% equity). The loan was sanctioned by the company in March **2017** though it was disbursed to him on 05-04-**2017**.

Solution

Taxability of various dividends in the hands of Mr. Bhisma is as under:

Name of foreign company	Nature of Dividend	Amount of Dividend (Rs.)	Year of Taxability
Lanka Limited	Normal Dividend	10,200	P.Y. 2016-17
Zakkas Private Limited	Deemed Dividend	12,00,000	P.Y. 2017-18

Reader's Note:

7.5 WINNINGS FROM LOTTERIES, CROSSWORD PUZZLES, HORSE RACES AND CARD GAMES, ETC.

Section:- 56(2)(ib), 58(4), 115BB, 194B, 194BB, Circular of CBDT

Any winnings from lotteries, crossword puzzles, races including horse-races, card games and other games of any sort or form, gambling or betting of any form or nature whatsoever shall be taxed under this head.

Meaning of term "Lottery"

The expression "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.

Meaning of term "card game and other game of any sort"

The expression "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.

(C) Expenditure in respect of winnings from lottery

As per Section 58(4), no deduction in respect of any expenditure or allowance in connection with income under the head "Income from other sources" shall be allowed under any provision of the Act in computing the income by way of 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. However, concept of diversion of income shall be kept in mind while taxing such winnings.

The above provision shall not apply to a person who is engaged in activity of owning and maintaining race horses.

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

Diversion of income means an obligation to apply the income in a particular way before it has accrued to the taxpayer. Such a diversion may take place under a legal compulsion. Sometimes, it may take place under a contractual obligation entered into before income accrued to the taxpayers.

Example:- Certain percentage has to be foregone by the winner to the Government/agency conducting the lotteries, is not taxable (as it amounts to diversion by overriding title) — Circular No. 461, dated July 9, 1986.

Application of income:- On the other hand, an obligation to apply income which has already been accrued or has been received amounts merely to the apportionment or application of the income and not to its diversion.

Example:- Person gives donation to a charitable trust out of his income is termed as application of income.

(E) Tax incidence on winnings from lotteries, etc. Section 115BB

As per this section, gross winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any nature whatsoever are chargeable to income-tax at a flat rate of 30 per cent.

The above provision shall not apply to an income from the activity of owning and maintaining race horses.

(F) TDS Provisions in respect of winning from lottery, crossword puzzle etc.

Section 194B

Any person responsible for paying any amount by way of winning from lottery, crossword puzzle, card game and other games of any sort, in excess of Rs.10,000 shall deduct tax @ 30%.

Section 194BB

Any person responsible for paying any amount by way of winning from horse races in excess of Rs.5, 000 (Rs. 10,000 w.e.f. 1st June, 2016) shall deduct tax @ 30%.

(G) Grossing Up of winning from lottery, cross word puzzle etc.

As gross winning is taxable, it shall be grossed up as follows:

Net winning received × 100 ÷ (100 — Rate of tax deduction at source).

Grossing up is not required when tax is not deducted at source.

Remark: On minute reading of section 194B and 194BB, TDS is not required to be deducted in respect of winning from other races, gambling or betting. Therefore, there is no need for grossing up if winnings are from these activities.

(H) Conceptual understanding between Activity of owning and maintaining horse races Vs. winnings from horse races.

Madras High Court in case of ***Mrs. Kamla Muthia vs. CIT 180 CTR 231 (2003)*** held that activity of owning and maintaining race horses is a business activity and therefore income from this activity is assessable under the head PGBP.

Therefore, person engaged in activity of owning and maintaining race horse is entitled to claim expenditure as per the provisions of head "PGBP".

7.6 SUM RECEIVED FROM EMPLOYEES AS THEIR CONTRIBUTION TOWARDS STAFF WELFARE SCHEMES

Section:- 56(2)(ic), 57(ia)

(A) Any sum received by the assessee from his employees as their contribution to any provident fund, or superannuation fund, or any fund, set up under the Employees' State Insurance Act, 1948 or any other fund for the welfare of employees is taxable as income from other sources, if the same is not taxable under the head "PGBP".

(B) Specific deduction that can be claimed against such income:

As per section Sec. 57(ia), deduction in respect of any sum received by a taxpayer as contribution from his employees towards any welfare fund of such employees is allowable only if such sum is credited by the assessee to the employee's account in the relevant fund before the due date under relevant Act.

7.7 INTEREST ON SECURITIES

Section:- 56(2)(id), 2(28B), 57(i), 94

Income by way of interest on securities is taxable under the head "Income from other sources", if the same is not taxable under the head "PGBP".

(J) Meaning of term "Interest on securities" *[Sec. 2(28B)]*

As per this section, interest on securities means —

(a) interest on any security of the Central Government or a State Government;

(b) interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.

(K) Basis of charge

Income by way of interest on securities is taxable on "receipt" basis if books of account are maintained on "cash basis". It is taxable on "due" basis when a person does not maintain books of account or when a person maintains books of account on the basis of "mercantile system".

(L) Specific deductions that can be claimed against income by way of interest on securities

As per section 57(i), any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realizing interest on securities, is deductible.

(M)Avoidance of tax by certain transactions in securities [Section 94]

(a) Bond-washing transactions [Section 94(1)]

This section provides that where a security owner transfers the securities (sometime before the due date of interest) to any other person (transferee) and re-acquires the same or similar securities and the interest is received by the transferee, the income from such securities will be deemed as income of the owner (transferor) and not of the any other person (transferee).

The above transaction is popularly known as bond-washing transaction.

Practical 12

Mr. Krishna subscribed 12% debentures of Dwarka Limited (Face value was also Rs. 10,00,000). Due date for payment of debenture interest is every 31st March. During the pervious year **2017-18**, Mr. Krishna has other taxable income of Rs. 15,80,200. On 11-03-**2018**, Mr. Krishna transferred these debentures to his friend Sudama. During the previous year **2017-18**, Mr. Sudama has other taxable income of Rs. 20,100. After due date of debenture interest is over, Mr. Krishna re-acquired debentures from Sudama. Under these circumstances, find out total income of Mr. Krishna and Mr. Sudama.

Solution

Present case of Mr. Krishna is covered by the provisions of section 94(1) i.e. bond washing transaction. The computation of total income of Mr. Krishna and Sudama after considering the effect of section 94(1) is as under:

Particulars	Mr. Krishna (in Rs.)	Sudama (In Rs.)
Interest on Debentures of Dwarka Limited	1,20,000	Nil
Other taxable income	15,80,200	20,100
Total Income	**17,00,200**	**20,100**

Reader's Note:

(b) Gain or loss to be ignored in the hands of transferee [Section 94(4)]

Where any person carrying on a business which consists wholly or partly in dealing in securities, buys or acquires any securities and sells back or retransfers the securities, then, if the result of the transaction is that interest becoming payable in respect of the securities is receivable by him but is not deemed to be his income by reason of the provisions contained in sub-section (1), no account shall be taken of the transaction in computing for any of the purposes of this Act the profits arising from or loss sustained in the business.

(c) Sales-cum-interest [Section 94(2)]

Section 94(2) provides that if assessee, having beneficial interest in securities during the previous year, sells them in such a way that either no income is received or income received is less than the sum he would have received if interest had accrued from day to day and been apportioned accordingly, then income from such securities for such year would be deemed be the income of such person.

Generally, this method is adopted while selling securities cum interest.

Practical 13

On 1st April, **2017**, Mr. Karna subscribed 12% debentures of Hastinapur Limited for Rs. 1,00,000 (Face value also Rs. 1,00,000). Due date for payment of debenture interest is every 31st March. Mr. Karna sold this debentures on 01-01-**2018** for Rs. 1,01,800 cum interest. He claims that Rs. 1,800 shall be taxed under the head "Capital Gain" and nothing shall be taxed under the head "Income from other sources". Whether claim of Mr. Karna is correct?

Solution

In the given question, Mr. Karna sold out debentures under sales cum interest method. After due consideration of the provisions of section 94(2), Mr. Karna is required to offer interest income of Rs. 9,000 under the head "Income from other sources. $\left(\text{Rs. } 1{,}00{,}000 \times 12\% \times \frac{9\ months}{12\ months}\right)$.

And the capital gain shall be computed as under:

Particulars	Rs.
Full value of consideration (Rs. 1,01,800-Rs.9,000)	92,800
Less: Cost of acquisition	1,00,00
Short term capital gain	**(7,200)**

Reader's Note:

(d) Relaxation from the applicability of Section 94(1) and 94(2) [Section 94(3)]

Deeming provisions of section 94(1) and (2), discussed above, are not applicable if the security owner proves to the satisfaction of the Assessing Officer that:

(i) there has been no avoidance of income-tax ; or

(ii) the avoidance of income-tax was exceptional and not systematic and there was no avoidance of income-tax u/s 94(1) and (2) in his case during the three preceding previous years.

(e) Power of Assessing officer to call for particulars [Section 94(6)]

The Assessing Officer may, by notice in writing, require any person to furnish him within such time as he may direct (minimum twenty-eight days), in respect of all securities of which such person was the owner or in which he had a beneficial interest at any time during the period specified in the notice, such particulars as he considers necessary for the purposes of this section and for the purpose of discovering whether income-tax has been borne in respect of the interest on all those securities.

(f) Loss on sale of shares, securities or units : Divided Stripping [Section 94(7)]

Before we refer dividend stripping – Section 94(7) and bonus stripping-Section 94(8), one shall first understand the concept of record date. As per explanation to section 94,

"Record date" means such date as may be fixed by—

(i) a company for the purposes of entitlement of the holder of the securities to receive dividend; or

(ii) a Mutual Fund for the purposes of entitlement of the holder of the units to receive income, or additional unit without any consideration, as the case may be;

Conditions - Section 94(7) comes into picture if following conditions are satisfied—

1. A person buys or acquires any securities /units within a period of 3 months prior to the record date.
2. Such person sells or transfers such-
   a. securities within a period of 3 months after the record date.
   b. Units within a period of 9 months after the record date.
3. The dividend or income on such securities / units received or receivable by such person is exempt.

Consequences if the above conditions are satisfied - Loss arising to the taxpayer on account of purchase and sale of securities /units, to the extent such loss does not exceed the amount of dividend income received or receivable on such securities /units, shall be ignored for the purpose of computing his income chargeable to tax.

Practical 14

R, an individual resident in India, bought 1,000 equity shares of Rs.10 each of A Ltd. a Rs.50 per share on **30.5.2017**. He sold 700 equity shares at Rs.35 per share on **30.9.2017** and the remaining 300 shares at Rs. 25 per share on **20.12.2017**. A Ltd. declared a dividend of 50%, the record date being 10.8.**2017**. R sold on 1.2.**2018**, a house from which he derived a long-term capital gain of Rs. 75,000.

Compute the amount of capital gain arising to R for the assessment year 20**18-19**.

Solution

Since dividend income is received by Mr. R, first job is to verify that whether section 94(7) is applicable on sale of each lot of shares?

	Number of shares sold	
	700 Shares	**300 Shares**
Date of purchase of shares	30.5.2017	30.5.2017
Record date	10.8.2017	10.8.2017
Date of sale of shares	30.9.2017	20.12.2017
Whether 94(7) is applicable or not?	Yes	No

Computation of capital gain on sale of shares of A Ltd. by Mr.R

Particulars	For 700 Shares (Rs.)	For 300 Shares (Rs.)
Sale Consideration	24,500	7,500
Less: Cost of Acquisition	35,000	15,000
Loss on sale of shares	10,500	7,500
Less: Dividend income as per section 94(7) [700 × 10 × 50%]	(3,500)	Sec. 94(7) Not Applicable
Short Term Capital Loss	7,000	7,500

Computation of capital gains of Mr. R for the assessment year 2018-19

Particulars	Rs.	Rs.
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	(14,500)
Taxable long-term capital gain		60,500

Reader's Note:

(g) Loss arising in the case of bonus stripping [Section 94(8)]

Where—

(a) any person buys or acquires any units within a period of three months prior to the record date; (called original units)

(b) such person is allotted additional units without any payment on the basis of holding of such units on record date; (called bonus units)

(c) such person sells or transfers all or any of the original units within a period of nine months after the record date, while continuing to hold all or any of the bonus units,

then,

(1) the loss, if any, arising to him on account of such purchase and sale of all or any of the original units units shall be ignored for the purposes of computing his income chargeable to tax **and,**

(2) the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of such bonus units as are held by him on the date of sale or transfer of original units.

Practical 15

Mr. Rohan purchased 2000 units of PNB Flexi Debt Fund on November 1, **2016** at the rate of Rs.25 per unit. On January 10, **2017**, being record date, he received 1000 bonus units. He then transferred all the original units on August 12, **2017** for Rs. 21 per unit. He further transferred 700 bonus units on April 15, **2018** for Rs. 11 per unit. Discuss tax consequences.

Solution

Computation of Capital Gain for the Previous Year 2017-18 in the hands of Mr. Rohan

Period of Holding: 01.11.2016 to 12.08.2017 Nature of Capital Asset: Short Term	
Particulars	**(Rs.)**
Full value of consideration (21 X 2000)	42,000
Less: Expenses in connection with Transfer	-
Net Consideration	42,000
Less: Cost of acquisition(25 X 2000)	(50,000)
Short Term Capital Loss	**8,000**

In view of section 94(8), Mr. Rohan cannot claim short term capital loss of Rs.8,000.

However, such loss of 8,000 shall be taken as cost of acquisition for bonus 1000 units. Therefore, cost of acquisition per bonus unit is Rs. 8 per unit

Considering the above,

Computation of Capital Gain for the Previous Year 2018-19 in the hands of Mr.Rohan

Period of Holding: 10.01.2017 to 15.04.2018 Nature of Capital Asset: Short Term	
Particulars	**(Rs.)**
Full value of consideration (11 X 700)	7,700
Less: Expenses in connection with Transfer	-
Net Consideration	7,700
Less: Cost of acquisition(8 X 700)	(5,600)
Short Term Capital Gain	**2,100**

Reader's Note:

7.8 TAX TREATMENT IN RESPECT OF DEEP DISCOUNT BONDS

Vide circular no. 2/2002, dated February 15, 2002.

This is applicable only in respect of bonds issued after February 15, 2002—

a. Every person holding a Deep Discount Bond will make a market valuation of the bond as on the March 31 of each financial year.

b. The difference between the market valuations as on two successive valuation dates will represent the accretion to the value of the bond during the relevant financial year and will be taxable as interest income (where the bonds are held as investments) or business income (where the bonds are held as trading assets).

c. Where the bond is transferred at any time before the maturity date, the difference between the sale price and the cost of the bond will be taxable as short-term capital gains in the hands of an investor or as business income in the hands of a trader. For computing such gains, the cost of the bond will be taken to be the aggregate of the cost for which the bond was acquired by the transferor and the income, if any, already offered to tax by such transferor up to the date of transfer.

d. Where the bond is redeemed by the original subscriber, the difference between the redemption price and the value as on the last valuation date immediately preceding the maturity date will be taxed as interest income in the case of investors or business income in the case of traders.

Practical 16

IDBI bank has issued deep discount bond on 01-04-2014. Face value of each bond is Rs. 50,000-term 20 years-offer price was Rs. 10,000. Mr. Shiv subscribed one bond on 01-04-2014. Subsequently he sold this bond on 12-12-17 for Rs 13,530. Discuss tax consequences of this transaction assuming that market valuation of bond on each 31st March is as under:

31st March, 2015 Rs.10, 800

31st March, 2016 Rs. 11,920

31st March, 2017 Rs. 13,130

Solution

(i) **Previous year 2014-15**

Interest income =Valuation as on 31st March 2015 *less* Purchase Price of Bond

= Rs.10,800-Rs.10,000

= Rs.800

(ii) Previous Year 2015-16

Interest Income =Valuation as on 31st March 2016 *less* Valuation as on 31st March 2015

= Rs.11,920-Rs.10,800

= Rs.1,120

(iii) Previous Year 2016-17

Interest Income =Valuation as on 31st March 2017 *less* Valuation as on 31st March 2016.

= Rs.13,130-Rs.11,920

= Rs.1,210

(iv) Previous year 2017-18

Short Term Capital gain =Selling Price *less [*Cost for which bond was acquired + Income already offered to tax up to the date of transfer*]*

= Rs.13,530- (Rs.10,000 + Rs.800+ Rs. 1,120 +Rs.1,210)

= Rs. 13, 530- Rs.13,130

= Rs. 400

Reader's Note:

7.9 INCOME FROM MACHINERY, PLANT OR FURNITURE LET ON HIRE

Section:- 56(2)(ii), 57(ii)

The income from machinery, plant or furniture let on hire shall be taxed under the head "IFOS", if it is not chargeable to tax under the head "Profits and gains of business or profession".

(E) For deciding the appropriate head of income, following two judicial pronouncements would be of great help.

(1) Supreme Court in Case of ***Universal Plast Ltd. v. CIT [1999] 237 ITR 454***

Brief facts of the case: Universal Plast Ltd. (assessee) set up a factory styled as "UPL factory" for carrying on the business of manufacturing PVC sheets and allied products. It appears that from the venture the assessee suffered losses for two years. It then entered into an agreement styled as 'leave and licence' agreement with M/s Leatherite Industries Limited for a period of 7 years. The agreement contains renewal clause giving option to the licensee to renew it for a further period of three years. This agreement also vests the right on licensee to purchase the licensed premise.

Guiding Principles: Supreme Court laid down the following general principles relating to income from leasing out the assets of the business by an assesse:

1. No precise test can be laid down to ascertain whether income (referred to by whatever nomenclature-lease amount, rent or license fee) received by an assessee from leasing or letting out of assets would fall under the head "Profits and gains of business or profession".
2. It is mixed question of law and fact and has to be determined from the point of a businessman in that business on the facts and in the circumstances of each case, including true interpretation of the agreement under which the assets are let out.
3. Where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the intention of the assesse is to go out of business altogether or to come back and restart the same.
4. If only a few of the business assets are let out temporarily, while the assessee is carrying on his other business activities, then it is a case of exploiting the business assets otherwise than employing them for his own use for making profit for that business; but if the business never started or has started but ceased with no intention to be resumed, the assets also will cease to be business assets and the transaction will only be exploitation of property by an owner thereof, but not exploitation of business assets.

Finding of the Supreme Court: Supreme Court upheld the finding of High Court which reads as under:

Considering the clauses of agreement, it can very well be presumed that at the time the licence agreement was entered into, the intention of the ultimate outright sell out was already there. The assessee was already committed to the licensee for such a sell-out at licensee's pleasure and there is no means of the assessee falling back from that commitment. Therefore, it can very reasonably be inferred that the assessee in the case decided to go out of business as far as this particular factory was concerned.

Therefore, income received by assessee by leasing out of factory was not a business income. But it shall be assessed under the head "Income From Other Sources"

(2) Supreme Court in case of ***S.K. Sahana & Sons Ltd. V. CIT [1999] 236 ITR 432***

Brief Facts of the case: S.K. Sahana & Sons Ltd. (assessee) leased its colliery (mining business) to the managing contractor. As per agreement, managing contractor has to carry out colliery business under the effective control and guidance of S.K. Sahana & Sons Ltd. For this arrangement, assesse was to be paid the profit at a certain rate on the amount of coal raised with a minimum guaranteed amount.

Finding of the Supreme Court: The relationship between assessee and its managing contractor is not that of lessor and lessee but it is of principal and agent. Therefore, the assessee's income from leasing of its business was to be assessed as business income and not as income from other sources.

(F) Specific deductions that can be claimed against such income.

As per provisions of section 57(ii), the following are deductible:

a. current repairs in respect of building [sec. 30(a)(ii)]
b. insurance premium in respect of insurance against risk of damage or destruction of the premises [sec. 30(c)]
c. repairs and insurance of machinery, plant and furniture [sec. 31]
d. depreciation [sec. 32].

Practical 17

An enterprise engaged in manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1.4.**2017** on a consolidated lease rent of Rs.50,000 per month. Compute the income for Assessment Year **2018-19** of the assessee from following information:

	Rs.
Expenses incurred on repairs of building, plant and machinery	15,000
Fire insurance premium of plant and machinery and furniture	12,000
Depreciation for the year	1,47,500
Legal fees paid to an advocate for drafting and registering the lease agreement	1,500
Factory licence fees paid for the year	1,000
There is unabsorbed depreciation of Rs. 2,75,000 of the Assessment Years **2016-17** and **2017-18**.	

Solution

Computation of income under the head "Income from other sources"

Particulars	Rs.	Rs.
Lease Rent for 12 months @ Rs.50,000 p.m		6,00,000
Less: Expenses and deductions allowable under section 57(ii) & 57(iii) -		
(i) Repairs	15,000	
(ii) Fire insurance premium of plant and machinery and furniture	12,000	
(iii) Depreciation for the year	1,47,500	
(iv) Legal fees paid to an advocate for drafting and registering the lease agreement	1,500	
(v) Factory licence fees paid for the year	1,000	
(vi) Unabsorbed depreciation of earlier assessment years-eligible for set off.	2,75,00	(4,52,000)
		1,48,000

Reader's Note:

7.10 INCOME FROM LETTING OF PLANT, MACHINERY OR FURNITURE ALONG WITH BUILDING AND LETTING OF BUILDING IS INSEPARABLE FROM THE LETTING OF PLANT, MACHINERY OR BUILDING

Section:- 56(2)(iii), 57(ii)

Income from letting of plant, machinery or furniture along with building and letting of building is inseparable from the letting of plant, machinery or building shall be taxed under the head "IFOS, if it is not chargeable to tax under the head "Profits and gains of business or profession".

(C) Concept of inseparable / separable letting

(1) Where letting of plant, machinery and furniture alongwith building and letting is inseparable –

Meaning of inseparable letting: It means letting of one is not acceptable without letting of other. Sometimes, letting of one is not possible without another is also called inseparable letting.

If letting is inseparable, then such income shall be taxed either under the head "Profits and gains from business or profession" or under the head " Income from other sources".

Therefore, once letting is inseparable, nothing shall be taxed under the head "house property". This rule is applicable even if amount of rent for two lettings has been fixed separately.

Illustration

Mr. Paresh owns house property. He also owns some movable furniture. Mr. Vimal is interested to take house property on rent. On the other hand, Mr. Paresh is interested to let the property alongwith furniture. Mr. Vimal agreed for both and further agreed to pay Rs. 5,000 p.m. for use of furniture and Rs. 15,000 p.m. for use of house property. Then, in this case, letting is inseparable, hence, entire rent income shall be taxed under the head "Profits and gains from business or profession" or under the head "Income from other sources". This rule is applicable even if amount of rent for building and furniture has been fixed separately.

(2) Where letting of plant, machinery and furniture alongwith building and letting is separable–

Meaning of separable letting: It means letting of one is acceptable without letting of other.
If letting is separable, then income from letting out of building is taxable under the head "Income from house property" and income from letting out of other assets is taxable either as business income or income from other sources.
This rule is applicable even if the assessee receives composite rent from his tenant for two lettings.

Illustration

Mr. Nirav gets Rs. 25,000 per month as rent from Mr. Pranav for letting out of a building and furniture. The two lettings are separable in the sense that Mr. Pranav was given an option to take on rent either the building at Rs. 20,000 or the furniture at Rs. 5,000 or both. Mr. Pranav agreed for both. Then, the rent of the building is taxable under the head "Income from house property" and the rent of furniture is taxable either as business income or income from other sources.

(D) Specific deductions that can be claimed against such income.

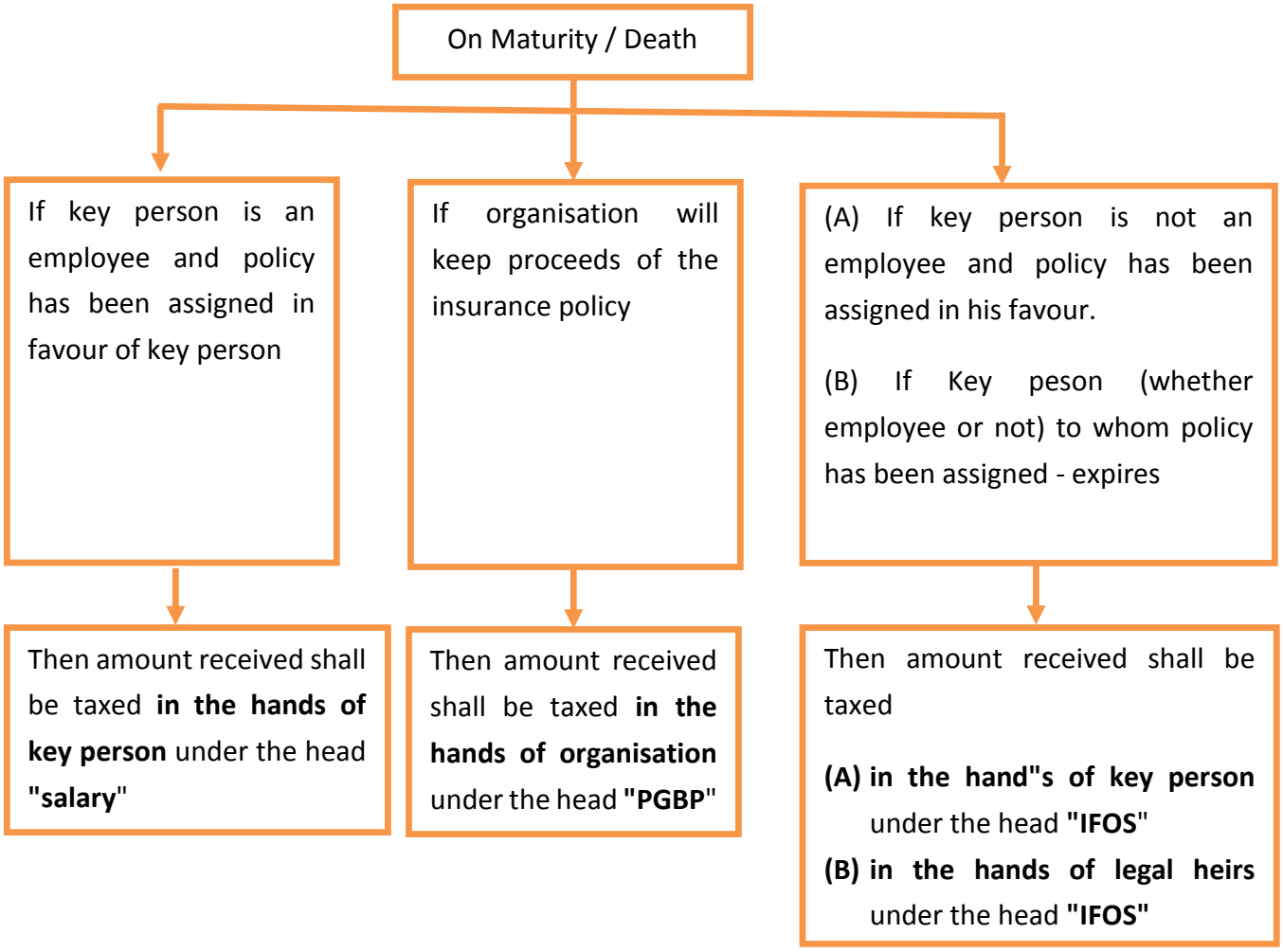
As per provisions of section 57(ii), the following are deductible:

a. current repairs in respect of building [sec. 30(a)(ii)]
b. insurance premium in respect of insurance against risk of damage or destruction of the premises [sec. 30(c)]
c. repairs and insurance of machinery, plant and furniture [sec. 31]
d. depreciation [sec. 32].

7.11 TAXABILITY OF KEYMAN INSURANCE POLICY

Section:- 56(2)(iv), Section 28, section 17(3)

Keyman insurance policy is a life insurance policy on the life of key person of the organization. Generally organization will pay premium on such policy and claims premium as business expenditure under section 37 (1).



7.12 SUM OF MONEY/PROPERTIES RECEIVED WITHOUT CONSIDERATION OR PROPERTIES RECEIVED FOR A CONSIDERATION WHICH IS LESS THAN FAIR MARKET VALUE OR STAMP DUTY, AS THE CASE MAY BE

Section:- 56(2)(x)

Following paragraphs deal with taxation of sum of money or properties received without consideration or properties received for a consideration which is less than fair market value or stamp duty, as the case may be.

Para No.	Description
Para 7.12	Sum of money/ properties received without consideration.
Para 7.12A	Exceptions / Relief from taxation
Para 7.12B	Meaning of Property
Para 7.12C	Determination of fair market value of Jewellery etc.
Para 7.12D	Determination of fair market value of Shares and Securities
Para 7.12E	What is the cost of acquisition if properties are subsequently sold?

Conditions for taxability:

If any person receives one or more of the following during the previous year from any other person, on or after the 1st day of April, 2017, then shall be regarded as income and subject to tax under this head:

(A) Sub Clause (a) of section 56(2)(x)

Transaction	***Condition***	***Taxable amount***
Sum of money received without consideration	*Aggregate amount received exceeds Rs.50,000*	***Aggregate** amount received*

Practical 18

During concerned previous year, Mr. Krishna received following sum of money without consideration. Discuss tax consequences.

From	**Rs.**
Friend A	17,000
Friend B	14,000
Friend C	19,000

Solution

Mr. Krishna received exactly Rs.50,000 (not exceeding Rs. 50,000) without consideration. Therefore nothing shall be taxed in his hands.

Reader's Note:

Practical 19

Suppose in the above problem, amount received from Friend C is Rs.19,001 instead of Rs. 19,000. Discuss tax consequences.

Solution

The aggregate amount received without consideration by Mr. Krishna is Rs.50,001 (exceeding Rs. 50,000), therefore, entire Rs. 50,001 shall be taxed in the hands of Mr. Krishna under the head "Income from other sources."

Reader's Note:

(B) Sub Clause (A) of section 56(2)(x)(b)

Transaction	***Condition***	***Taxable amount***
Immovable property received without consideration	*Stamp duty value of immovable property exceeds Rs50, 000.*	*Stamp duty value of such property. (This rule shall be applicable for **each property separately)***

Practical 20

During concerned previous year, Mr. Yudhisthir received following urban lands without consideration.

From	Valuation for Stamp Duty Purpose (Rs.)
Friend P	32,000
Friend Q	68,000

Solution

The valuation of land received from friend "P" does not exceed Rs. 50,000 (It is Rs. 32,000), therefore, it shall not be taxed in the hands of Mr. Yudhisthir. However, value of land received from friend "Q" exceeds Rs. 50,000 (It is Rs. 68,000), the same shall be taxed.

Reader's Note:

Practical 21

Suppose in the above problem, land received from friend Q is an agricultural land instead of urban land. Discuss tax consequences.

Solution

Since land received from Friend Q is not a capital asset (in this case, it is an agricultural land), nothing shall be taxed in the hands of Mr. Yudhisthir even though value of this land exceeds Rs. 50,000.

Reader's Note:

(C) Sub Clause (B) of section 56(2)(x) (b)

Transaction	*Condition*	*Taxable amount*
Immovable property received for a consideration which is less than the stamp duty value.	*Consideration is less than the stamp duty value of the property by an amount exceeding Rs. 50,000. (Refer Note)*	*Difference between stamp duty value and the consideration (This rule shall be applicable for **each property separately**)*

Notes:

1. If there is a time gap between date of agreement and date of registration, **the stamp duty value may be taken as on the date of agreement** instead of the date of registration. However, for this purpose, at least a part of the consideration has been paid by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of agreement.

2. If assessee may dispute the stamp duty value of property on grounds mentioned under section 50C(2),then the assessing officer may refer the valuation of such property to the valuation officer, and the provisions of section 50C and section 155(15) shall apply accordingly for the purpose of sub clause (b) of Section 56(2)(x).

Practical 22

Shweta purchased flat from Rahul, details of which are as under:

1. Date of entering into agreement :-1.7.**2017**.
2. Agreed consideration : Rs. 100 lakhs
3. Down payment of Rs. 15 lakhs was paid by cheque on the date of agreement.
4. Stamp duty value of flat on the date of agreement was Rs. 135 lakhs.
5. Registration of sale deed in respect of flat took place on 1.1.**2018**.
6. Stamp Duty value on the date of registration of sale deed was Rs. 150 lakhs.

Discuss tax implications in the hands Shweta.

Solution

(1) Taxable Amount under the head "Income from Other Sources"

Taxable Amount =Stamp Duty Value ***Less*** Actual Consideration

= Rs.135 lakhs – Rs.100 lakhs

= Rs. 35 lakhs

(2) Further, Shweta shall deduct TDS under section 194 IA at 1 % of consideration (Reader must note that 1% is not of stamp duty value, it is of consideration). Therefore, Shweta shall deduct TDS of Rs. 1,00,000/- while making payment to Rahul.

Reader's Note:

(D) Sub Clause (A) of section 56(2)(x) (c)

Transaction	*Condition*	*Taxable amount*
Movable property received without consideration	*Aggregate fair market value of movable properties exceeds Rs 50,000*	*fair market value* ***on aggregate basis***

Practical 23

During concerned previous year, Mr. Arjuna received following properties without consideration. Discuss tax consequences.

Description of Property	Fair Market Value (Rs.)
Jewelry from friend M	27,000
Archeological Collections from friend N	14,000
Mobile from friend O	15,000

Solution

Description of Property	Fair Market Value (Rs.)
Jewelry from friend M	27,000
Archeological Collections from friend N	14,000
Mobile from friend O **(Not covered within the meaning of property)**	-
Aggregate	**41,000**

Since aggregate amount does not exceed Rs. 50,000, nothing is taxable in the hands of Mr. Arjuna.

Reader's Note:

(E) Sub Clause (B) of section 56(2)(x) (c)

Transaction	*Condition*	*Taxable amount*
Movable property received for a consideration which is less than the aggregate fair market value.	*Consideration is less than the aggregate fair market value of properties by an amount exceeding Rs 50,000*	*Difference between fair market value and consideration **on aggregate basis***

Practical 24

During concerned previous year, Mr. Bhima purchased following properties. Discuss the tax consequences.

Particulars	Fair Market Value (Rs.)	Purchase Price
Golden Ring	78,000	72,000
L.C.D. Television	42,000	32,000
Paintings	1,00,000	61,000

Solution

Particulars	Fair Market Value (Rs.)	Purchase Price (Rs.)	Difference (Rs.)
Golden Ring	78,000	72,000	6,000
L.C.D.Television**(Not covered within the meaning of property)**	-	-	-
Paintings	1,00,000	61,000	39,000
Aggregate of Difference			45,000

Since aggregate amount does not exceed Rs. 50,000, nothing is taxable in the hands of Mr. Bhima.

Reader's Note:

Practical 25

Suppose in the above problem painting was purchased for Rs.51,000 instead of Rs. 61,000. Discuss the tax consequences.

Solution

Particulars	Fair Market Value(Rs.)	Purchase Price(Rs.)	Difference (Rs.)
Golden Ring	78,000	72,000	6,000
L.C.D.Television**(Not covered within the meaning of property)**	-	-	-
Paintings	1,00,000	51,000	49,000
Aggregate of Difference			55,000

Since aggregate amount exceeds Rs. 50,000, entire difference of Rs. 55,000 is taxable in the hands of Mr. Bhima.

Reader's Note:

Practical 26

Mr. Nakula provides the following information for the concerned previous year. Discuss the tax consequences.

(i) Received gift of Rs. 48,000 from friend X.

(ii) Received house property without consideration from friend's grandmother, valuation of the same for stamp duty purpose was Rs. 42,000.

(iii) Purchased urban land for Rs. 11,82,000 though the value of the same for stamp duty purpose was Rs. 11,00,000.

(iv) Received gift of shares worth Rs. 29,000

(v) Purchased sculpture for Rs.9,000 though fair market value was Rs.49,000

Solution

Tax Consequences in the hands of Mr. Nakula

Sr. No.	Particulars	Relevant Para Applicable (Rs.)				
		Para 7.12 (A)	**Para 7.12 (B)**	**Para 7.12 (C)**	**Para 7.12 (D)**	**Para 7.12 (E)**
(i)	Received Cash	48,000				
(ii)	Received House property without consideration		42,000			
(iii)	Purchased Urban land			Refer Note		
(iv)	Gift of Shares				29,000	
(v)	Sculpture					40,000
	Which rule Applicable- Aggregation or each transaction?	Aggregate	Each transaction	Each transaction	Aggregate	Aggregate
	Aggregate	48,000	NA	NA	29,000	40,000
	Taxability	**Not Taxable**	**Not Taxable**	**Not Taxable**	**Not Taxable**	**Not Taxable**

Reader's Note:

Note: Section 56 is not applicable since Nakula purchased land for a value more than the value adopted for stamp duty purpose.

7.12A EXCEPTIONS / RELIEF FROM TAXATION

Section:- Proviso to section 56(2)(vii)

While calculating the above monetary limit of Rs. 50,000, any sum of money/properties received form the following shall not be considered.

1. Any sum of Money/properties which is received from any relative
2. Any sum of Money/properties which is received on the occasion of the marriage of the individual.
3. Any sum of Money/properties which is received under a will or by way of inheritance.
4. Any sum of Money/properties which is received in contemplation of death of the payer.
5. Money/properties received from a local authority
6. Money/properties received from any fund, foundation, university, other educational institution, hospital, medical institution, any trust or institution referred to in section 10(23C).
7. Money/properties received from a charitable institute registered under section 12AA.
8. Money/properties received by way of transaction not regarded as transfer under clause (vicb) or clause (vid) or clause (vii) of section 47. [i.e., receipt of money/ properties in a scheme of amalgamation, demerger, etc.]
9. Money / properties received by a trust from an individual where trust is created or established solely for the benefit of relative of the individual.

Meaning of relative in relation to "Individual" -For the aforesaid purpose, the term "relative" in relation to "Individual" means—

1. Spouse of the individual
2. Brother or sister of the individual
3. Brother or sister of the spouse of the individual
4. Brother or sister of either of the parents of the individual
5. Any lineal ascendant or descendant of the individual
6. Any lineal ascendant or descendant of the spouse of the individual
7. Spouse of the person referred to in (2) to (6)

Meaning of relative in relation to "HUF" - For the aforesaid purpose, the term "relative" in relation to "HUF" means any member thereof.

That means any sum of money or property received without consideration or for an inadequate consideration by an HUF from its members will not be subject to tax.

Practical 27

Mr. Jayesh received gift of Rs. 1, 00,000 from his uncle. Discuss tax consequences in the hands of Mr. Jayesh.

Solution

Mr. Jayesh received Rs.1,00,000 from his uncle who falls under the definition of relative for Mr. Jayesh. Any sum of money / property received from relative does not fall under section 56(2)(vii), therefore, nothing shall be taxed in the hands of Mr. Jayesh.

Reader's Note:

Practical 28

Mr. Uncle received gift of Rs. 1,00,000 from his nephew. Discuss tax consequences in the hands of Mr. Uncle.

Solution

Mr. Uncle received Rs.1,00,000 from his nephew who does not fall under the definition of relative for Mr. Uncle. And amount received exceeds Rs. 50,000 therefore entire Rs. 1,00,000 shall be taxed in the hands of Mr. Uncle.

Reader's Note:

Practical 29

Mr. Manmoji received gold from various persons without consideration. The fair market value of gold is Rs. 1,25,000. Discuss tax consequences in the hands of Mr. Manmoji under following alternatives:-

Alternative (a) : Mr. Manmoji received gold on occasion of his marriage.

Alternative (b) : Mr. Manmoji received gold on his 25th marriage anniversary.

Solution

Alternative (a)

For the purpose of section 56(2(vii), any sum of money/properties received on the occasion of the marriage of the individual shall excluded.

Therefore, gold received on the occasion of marriage by Mr. Manmoji is not taxable.

Alternative (b)

As discussed above, For the purpose of section 56 (2)(vii), any sum of money/properties received on the occasion of the marriage of the individual shall excluded. However it does not exclude any money/properties received on the occasion of marriage anniversary from non-relative.

Therefore, gold receive worth Rs. 1,25,000 (exceeding Rs. 50,000) on the occasion of 25th marriage anniversary shall be chargeable to tax in the hands of Mr.Manmoji.

Reader's Note:

7.12B MEANING OF PROPERTY

Section:- 56(2)(vii)

"Property" *means capital asset of the assessee being*

(i) immovable property being land or building or both;
(ii) shares and securities;
(iii) jewellery;
(iv) archaeological collections;
(v) drawings;
(vi) paintings;
(vii) sculptures;
(viii) any work of art;
(ix) *bullion;*

Practical 30

During concerned previous year, Mr. Sahdev received 1,000 shares of WIPRO Limited from his friend, without consideration. Fair market value of this shares on the date of gift was Rs. 2,500 per share. Discuss tax consequences in the hands of Sahdev under following alternatives:-

Alternative (a): Mr. Sahdev is a share trader

Alternative (b): Mr. Sahdev is not a share trader

Solution

On minute reading of the definition of property, it shall be taxed in the hands of recipient only if it is a capital asset for the recipient.

Alternative (a):- In this alternative, Mr. Sahdev is a share trader and if he treats the shares of WIPRO Limited received by him from his friend as a part of stock-in-trade (not a capital asset), then nothing shall be taxed under section 56(2)(x)(c)(A)

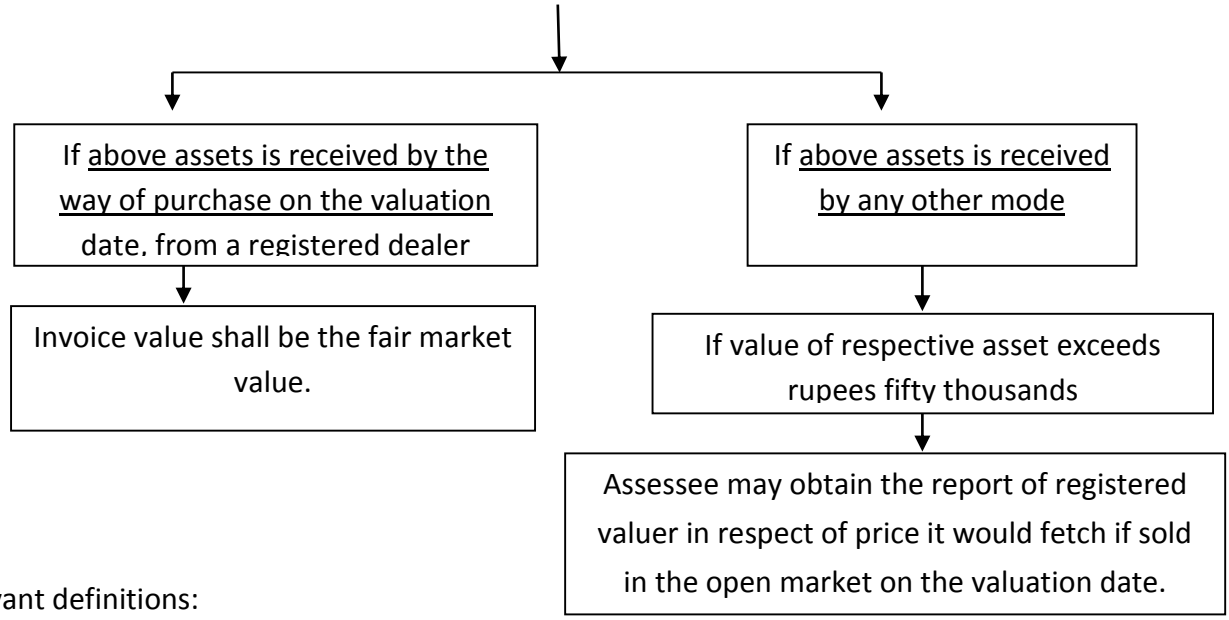
Alternative (b):- In this alternative, Mr. Sahdev is not a share trader and therefore, shares of WIPRO Limited received by him from his friend are capital asset. Hence, Rs. 25,00000 (Fair market value) shall be taxed under section 56(2)(x)(c)(A).

Reader's Note:

7.12C DETERMINATION OF FAIR MARKET VALUE OF JEWELLERY, DRAWINGS ETC.

Rule:- 11 U, 11 UA

The FMV of jewellery, archeological collections, drawings, paintings, sculptures or any work of art shall be estimated to be price which it would fetch if sold in the open market on the valuation date: Consider following chart:-



Relevant definitions:

1) **Registered dealer**

   "registered dealer" means a dealer who is registered under Central Sales tax Act, 1956 or General Sales-tax Law for the time being in force in any State including value added tax laws.

2) **Registered valuer**

   "Registered valuer" shall have the same meaning as assigned to it in section 34AB of the Wealth Tax Act, 1957 read with rule 8A of wealth-tax Rules, 1957.

3) Valuation date

"valuation date" means the date on which the property is received by the assessee.

Practical 31

Ms. Jaya purchased diamond jewellery from "Abhushan" Jewellers, a registered dealer under Gujarat VAT Act for Rs. 55,000. Similar jewellery was purchased by Ms. Chhaya on the same day from "Kalyan Jewellers", a registered dealer under Gujarat VAT Act for Rs. 62,000. Find out fair market value for the purpose of section 56 in the hands of Ms. Jaya and Ms. Chhaya under following alternatives:-

Alternative (a): Both Ms. Jaya and Ms. Chhaya have obtained the invoice from respective jewellers.

Alternative (b): Both Ms. Jaya and Ms. Chhaya have not obtained the invoice from respective jewellers

Alternative (c): Both Ms. Jaya and Ms. Chhaya have obtained the invoice from respective jewellers but both the jewellers are unregistered.

Solution

Alternative (a): Both Ms. Jaya and Ms. Chhaya have obtained the invoice from respective jewellers.

If diamond is purchased from a registered dealer by obtaining invoice, then as per valuation rule, invoice value shall be the fair market value.

Therefore, respective invoice value of the diamond shall be the fair market value in the hands of Ms. Jaya and Ms. Chhaya.

Alternative (b): Both Ms. Jaya and Ms. Chhaya have not obtained the invoice from respective jewellers

If diamond is purchased from a registered dealer without obtaining invoice, then as per valuation rules, assessee may obtain the report of registered valuer in respect of fair market value of diamond on the date of purchase.

Alternative (c): Both Ms. Jaya and Ms. Chhaya have obtained the invoice from respective jewellers but both the jewellers are unregistered.

If Diamond is purchase from a unregistered dealer, then as per valuation rules, assessee may obtain the report of registered valuer in respect of fair market value of diamond on the date of purchase.

Reader's Note:

Practical 32

Ms. Kamli purchased gold jewellery from "Gharana Jewellers', being unregistered dealer for Rs. 45,000. Further, she purchased painting from "Modern Art" being unregistered dealer for Rs. 38,000. Is Ms. Kamli required to obtain report of registered valuer?

Solution

On reading of valuation rule, Ms. Kamli required to obtain report of registered valuer only when the value of respective asset exceeds fifty thousand rupees. In this case, value of each asset (i.e. jwellery and painting) does not exceed Rs.50,000, therefore, Ms Kamli is not required to obtain report from registered valuer.

Reader's Note:

Practical 33

Mr. Viru purchased painting on **5th May, 2017** from registered dealer for Rs.1, 00,000 and obtained the invoice of same. He gifted this painting to Miss Mohmaya on **9th September 2017**. Fair market value of this painting, as per registered valuer report on **9th September, 2017** was Rs.1, 25,000. Discuss taxability of this transaction in the hands of Miss Mohmaya.

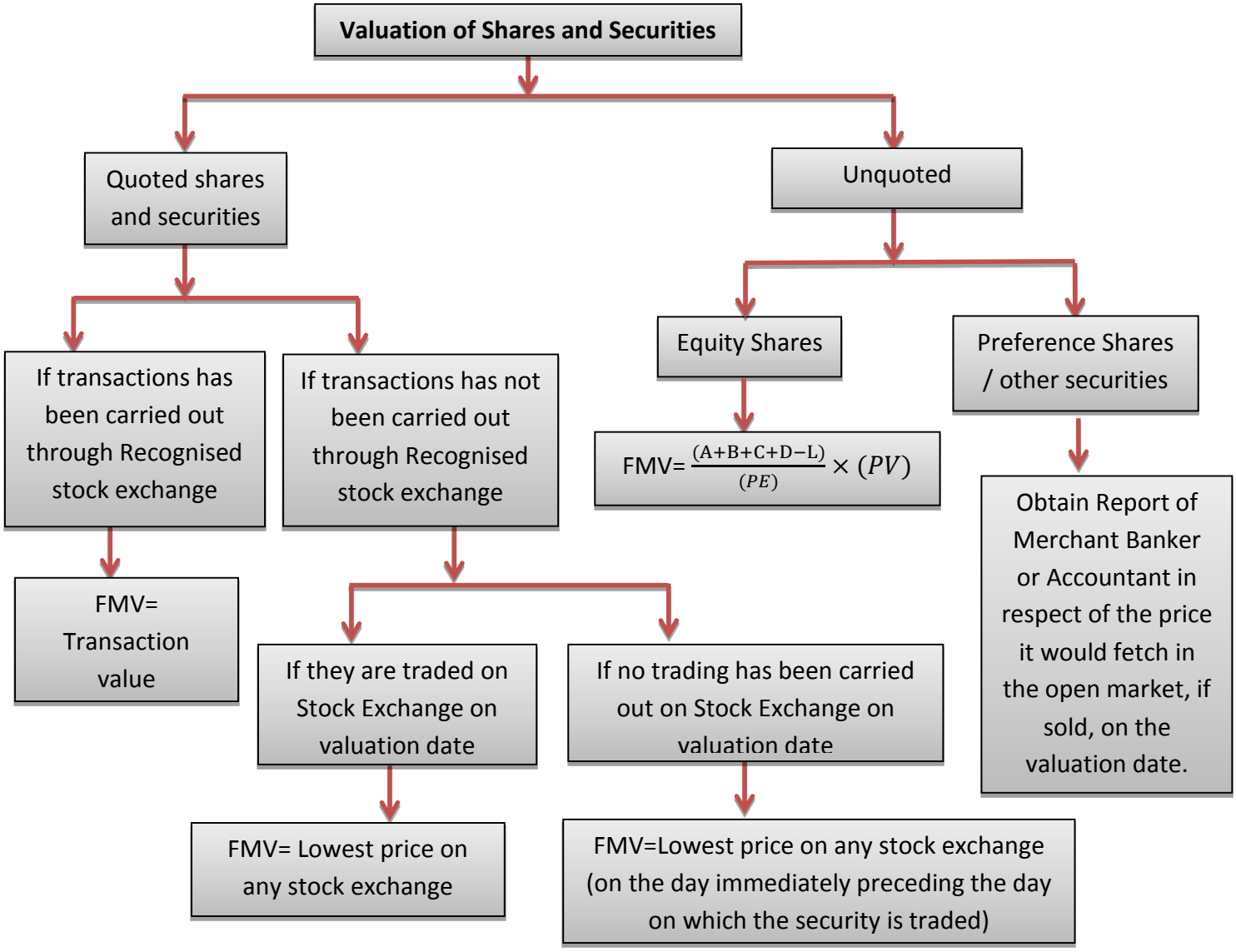
Solution

Miss Mohmaya has received paintings without consideration, therefore, fair market value of painting on the date of gift (i.e. Rs.1,25,000) shall be chargeable to tax in her hands.

Reader's Note:

7.12D DETERMINATION OF FAIR MARKET VALUE OF SHARES AND SECURITIES

RULE:- 11U, 11UA



Meaning of various terms used in the above valuation rule:

A= book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by,-

(i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and

(ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

C = fair market value of shares and securities as determined in the manner provided in this rule;

D = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property;

L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

(i) the paid-up capital in respect of equity shares;

(ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;

(iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

(iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

(v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

(vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PV= the paid up value of such equity shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet;"

Relevant definitions

(a) "accountant" shall have the same meaning as assigned to it in the Explanation below sub-section (2) of section 288 of the Act;

(b) The balance-sheet in relation to any company means balance sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor appointed u/s 224 of the Companies Act, 1956(1 of 1956);

(c) "Merchant banker" means category I merchant banker registered with Security and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(d) "quoted shares or securities" in relation to share or securities means a share or security quoted on any recognized stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;

(e) "recognized stock exchange" shall have the same meaning as assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(f) "securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(g) "unquoted shares and securities", in relation to shares or securities, means shares and securities which is not a quoted shares or securities;

(h) "valuation date" means the date on which the property is received by the assessee.

Practical 34

Mr. Abhishek gifted 10,000 unquoted shares of Ajitabh Bachhan Corporation Limited (ABCL) to Dr. Deval on **10th July, 2017**. Find out amount, if any, to be taxed in the hands of Dr. Deval under the head "Income from other sources".

Balance Sheet of ABCL on 10th July, 2017

Liabilities	Rs. In crores	Assets	Rs. In crores
30,00,000 equity shares of Rs.10 each	3.00	Fixed Assets	10.00
12% Cumulative Preference shares	2.00	Investments	2.00
Reserves and Surplus	1.50	Current Assets	2.00
Loan funds	2.50		
Current liabilities	5.00		
	14.00		**14.00**

Additional information:

(i) Fixed assets represents immovable properties of the company and the valuation assessable for the purpose of stamp duty for these assets is Rs. 25 Cr.

(ii) Investment represents investment in shares and securities, the fair market value of such investments in accordance with Rule 11UA is Rs. 3.5 Cr.

(iii) Current Asset includes advance tax Rs.50 lakh.

(iv) Current liability includes

a. Provision for unascertained liability Rs. 30 lakhs
b. Proposed dividend Rs.10 lakhs.

(v) Reserve and Surplus includes Depreciation Reserve Rs. 22.50 lakhs

(vi) Further, company reported contingent liabilities Rs. 55 lakhs which includes unpaid preference dividend of one year.

Solution

Amount to be taxed in the hands of Dr. Deval = 10,000 shares x Rs. 68.12 = Rs.6,81,200

Working Notes:

Calculation of Fair Market Value as on 10th July, 2017

Fair Market Value $= \frac{(A+B+C+D-L)}{PE} \times PV$

$= \frac{(1.5\ Cr+Nil+3.50\ Cr+25Cr-9.565\ Cr)}{3.00\ Cr} \times 10$

= Rs. 68.12 per share

Calculation of Assets (A)

Particulars	**Rs.in crores**
Total Assets	14.00
Less: Fixed Assets	(10.00)
Less: Investments	(2.00)
Less: Advance Tax	(0.50)
Assets (A)	**1.50**

Calculation of Assets (B) = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer = **NIL**

Calculation of Assets (C) = fair market value of shares and securities as determined in the manner provided in this rule = **Rs. 3.5 Cr**

Calculation of Assets (D) = the value assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property = **Rs. 25Cr**.

Calculation of Liabilities (L)

Particulars	**Rs.in crores**
Total Liabilities	14.00
Less:(1) Paid up equity share capital	(3.00)
(2) Provisions for unascertained liabilities	(0.30)
(3) Proposed dividend	(0.10)
(4) Reserves and surplus (other than depreciation reserve)	(1.275)
Add: Unpaid Preference share dividend	0.24
Liabilities (L)	**9.565**

Calculation of PE

PE =Total amount of paid up equity share capital as shown in the balance sheet

= **Rs. 3.00 crores**

Calculation of PV

PV = the paid value of equity share = **Rs.10**

Reader's Note:

7.12E WHAT IS THE COST OF ACQUISITION IF PROPERTIES ARE SUBSEQUENTLY SOLD?

Section:- 49(4) and 49(1)

Particulars	Section Applicable	Cost of acquisition	Period of holding
Gift transaction – taxable under section 56(2)	Section 49(4)	Value adopted for purpose of section 56	Period of holding of previous owner **not included**
Gift transaction – not taxable under section 56 (2)	Section 49(1)	Cost to the previous owner	Period of holding of previous owner **included**

Practical 35

Mr. Surya purchased diamond ring for Rs. 38,000 on ***09-09-14.*** He gifted the same to Miss Maya on ***14-02-2017***, on that day fair market value of this diamond ring was Rs. 48,000. It is the only gift received by Miss Maya during previous year 2016-17. After break-up with Mr. Surya, Miss Maya sold out this diamond ring for Rs. 52,000 on ***12-12-17.*** Discuss tax consequences in the hands of Miss Maya.

Cost of Inflation Index 2014-15: 240 2017-18: 272

Solution

In the hands of Miss Maya

(1) Taxability for the P.Y. 2016-17

Aggregate fair market value of gift received by Miss Maya does not exceed Rs. 50,000 therefore, nothing is taxable for the previous year 2016-17.

(2) Taxability for the P.Y. 2017-18

Period of Holding: 09-09-2014 to 12-12-2017
Nature of Capital Asset: Long Term

Particulars	(Rs.)
Full value of consideration	52,000
Less: Expenses in connection with Transfer	-
Net Consideration	52,000
Less: Cost of acquisition $\left(38{,}000 \times \frac{272}{240}\right)$	(43,066)
Long Term Capital Gain	**8,934**

Reader's Note:

Practical 36

Suppose in the above problem Miss Maya also received gift of gold ornament worth Rs. 22,000 on **30-03-2017** from another boy-friend Mr. Prakash. Discuss tax consequences assuming that she sold out diamond ring received from Mr. Surya as per the information given in above problem.

Solution

(1) Taxability for the P.Y. 2016-17

Particulars	Fair Market Value (Rs.)
Diamond Ring from Mr. Surya	48,000
Gold Ornament from Mr. Prakash	22,000
Aggregate	**70,000**

Aggregate fair market value of gift received by Miss Maya exceeds Rs. 50,000 therefore, Rs.70,000 shall be taxed for the previous year 2016-17

(2) Taxability for the P.Y. 2017-18

Period of Holding: 14-02-2017 to 12-12-2017

Particulars	Rs.
Full value of consideration	52,000
Less: Cost of acquisition **u/s 49(4)**	(48,000)
Short Term Capital Gain	4,000

Reader's Note:

7.13 SHARE PREMIUM IN EXCESS OF THE FAIR MARKET VALUE TO BE TREATED AS INCOME

Section:- 56(2)(viib), Rule 11UA(2)

(A) Taxability

Conditions

1. Taxpayer is a company in which the public are not substantially interested.
2. It receives consideration for issue of shares from a resident person.
3. The consideration received for issue of shares exceeds the face value of such shares. (i.e. shares are issued at a premium).
4. The aggregate consideration received for such shares exceeds the fair market value of the shares.

If all the above mentioned conditions are satisfied then following shall be chargeable to income-tax in the hands of closely held company under section 56(2)(viib) under the head "Income from other sources".

Taxable Amount = Aggregate consideration received for shares (less) fair market value of shares.

Practical 37

Discuss the applicability of the provisions of section 56(2)(viib) in respect of the shares issued by the following closely held companies to resident Indians –

Company	Consideration received for issue of a share	Face value of a share	Fair Market Value (FMV) of a share	Number of shares issued
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
ABC (P) Ltd.	170	100	150	1,00,000
DEF (P) Ltd.	130	100	150	2,00,000
PQR (P) Ltd.	290	300	280	3,00,000

Solution

Company	**Face value of a share**	**Fair Market Value (FMV) of a share**	**Consideration received for issue of a share**	**Applicability of section 56(2)(viib)**
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
ABC (P) Ltd.	100	150	170	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium (i.e., issue price exceeds the face value of shares). The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib).i.e., Rs. 20 lakh, being Rs. 20 (Rs.170 – Rs. 150) per share × 1,00,000 shares, shall be treated as income in the hands of ABC (P) Ltd.
DEF (P) Ltd.	100	150	130	The provisions of section 56(2)(viib) are attracted since the shares are issued at a premium. However, no sum shall be chargeable to tax under the said section in the hands of DEF (P) Ltd. as the shares are issued at a price less than the FMV of shares.
PQR (P) Ltd.	100	80	190	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.

Reader's Note:

(B) Exception:

However, provision of this section shall not apply in the following two cases –

a. where the consideration for issue of shares is received by a venture capital undertaking from a venture capital company or a Venture capital fund; or

b. where the consideration for issue of shares is received by a company from a class or classes of person notified by the Central Government. (Resident "start up" company has been notified for this purpose- vide notification no. 45/2016)

(C) Meaning of Fair Market Value

The fair market value of the shares shall be the higher of the value—

(a) as may be determined in accordance with the method as may be prescribed; **[Refer Rule 11UA(2) given below]**

Rule 11UA (2):-

The fair market value of unquoted equity shares shall be :-

(1) (A+B+C+D-L) * (PV) / (PE)

Or

(2) The fair market value of the unquoted equity shares determined by a merchant banker or an accountant as per the Discounted Free Cash Flow method.

whichever is higher:

(b) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value of its assets, including intangible assets, being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

Meaning of certain terms used for Rule 11 UA (2):

(i) "balance-sheet", in relation to any company, means the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under section 224 of the Companies Act, 1956 (1 of 1956)

and

(ii) where the balance-sheet on the valuation date is not drawn up, the balance-sheet (including the notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company;

(iii) "accountant" means a fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949 (38 of 1949) who is not appointed by the company as an auditor under section 44AB of the Act or under section 224 of the Companies Act, 1956 (1 of 1956);

(iv) Valuation date: "valuation date" means the date on which consideration is received by the assessee.

(v) Term "A", "B", "C", "D", "L", "PV" and "PE" has same meaning as assigned in earlier valuation rules.

7.14 TAXABILITY OF INTEREST RECEIVED ON COMPENSATION OR ENHANCED COMPENSATION

Section:- 56(2)(viii), 57(iv)

1. As per provision of this section, income by way of interest received on compensation or on enhanced compensation shall be assessed as "income from other sources".

2. Section 145A has been amended to provide that such interest received shall be deemed to be the income for the year in which it is received, irrespective of the method of accounting followed by the assessee.

3. Deductions that can be claimed from such interest income
   As per section 57(iv), adhoc deduction of 50 percent of such interest income shall be allowable. Once this deduction is claimed, no other deduction shall be available against such income.

Practical 38

On 1st October 1996, house property of Mr. X was compulsorily acquired by the Central Government. On 1st August 2010, Mr. X received a compensation of Rs 14 lacs in lieu of the house compulsory acquired. He filed a suit in the court of law for the interest due on delayed payment of compensation. On 3rd October **2017**, Mr. X received interest on compensation Rs 2,00,000. He paid fees of Rs. 20,000 to advocate. Find out taxable interest income.

Solution

Particulars	**Rs.**
Interest received on compensation (Taxable in the year of receipt)	2,00,000
Less: Adhoc deduction under section 57 (50% of Interest income)	(1,00,000)
Less: Fees paid to Advocate (Not deductible because adhoc deduction claimed)	Nil
Income Chargeable to tax	**1,00,000**

Reader's Note:

7.15 ANY SUM OF MONEY RECEIVED AS AN ADVANCE OR OTHERWISE IN THE COURSE OF NEGOTIATIONS FOR TRANSFER OF A CAPITAL ASSET, IF, - (A) SUCH SUM IS FORFEITED; AND (B) THE NEGOTIATIONS DO NOT RESULT IN TRANSFER OF SUCH CAPITAL ASSET.

Section:- 51, 56(2)(ix)

(A) Section 51 (applicable for advance received up to 31.03.2014)

Where any capital asset was on any previous occasion the subject of negotiations for its transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

(B) Section 56(2)(ix) (applicable to advance received after 31.03.2014)

Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if,—

(a) such sum is forfeited; and

(b) the negotiations do not result in transfer of such capital asset;

shall be treated as income as per section 2(24)(xii) and to be taxed under the head "Income From Other Sources" and it shall not be reduced from cost of acquisition or written down value, as the case may be.

Practical 39

Mr. Rakesh purchased a house property on 14th April, 2012 for Rs.21,05,000. He entered into an agreement with Mr. Bobby for the sale of house on 15thSeptember, 2013 and received an advance of Rs.2,00,000. Since Mr. Bobby did not remit the balance amount, Mr. Rakesh forfeited the advance. Later on, he sold out this house property to Mr. Aakash on 15th March, 2015 for Rs. 28,00,000. Mr. Rakesh incurred brokerage expense Rs. 28,000.

Discuss tax consequences.

Solution

Computation of income under the head "Capital Gains"

	Particulars	Amount Rs.
	Full Value of Consideration	28,00,000
Less:	Expenses incurred in connection with transfer	(28,000)
	Net Consideration	27,72,000
Less:	Cost of Acquisition [Rs.21,05,000-Rs.2,00,000]	(19,05,000)
	Short Term Capital Gain	**8,67,000**

Reader's Note:

Practical 40

What would have been your answer if Mr. Rakesh forfeited Rs. 2,00,000 on 15th September, 2014 instead of 15th September, 2013?

Solution

Computation of income under the head "Capital Gains"

	Particulars	Amount Rs.
	Full Value of Consideration	28,00,000
Less:	Expenses incurred in connection with transfer	(28,000)
	Net Consideration	27,72,000
Less:	Cost of Acquisition	(21,05,000)
	Short Term Capital Gain	**6,67,000**

Further, Rs.2,00,000 forfeited on 15th September, 2014 shall be taxed under the head "Income From other Sources" and shall not be deducted from cost of acquisition.

Reader's Note:

7.16 GENERAL DEDUCTION UNDER THIS HEAD & DEDUCTION FROM FAMILY PENSION

Section:- 57(iii)

(A) Section 57(iii)

As per section 57(iii), any other expenditure is deductible under this head if the following four conditions are satisfied:

a. the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning the income;
b. the expenditure must not be in the nature of capital expenditure;
c. it must not be of personal nature;
d. it must be incurred during the previous year.

(B) Important ratio laid down by Supreme Court in case of CIT v. Rajendra Prasad Moody (SC) 115 ITR 519

Supreme Court in case of CIT v. Rajendra Prasad Moody (SC) 115 ITR 519 held that interest paid on money borrowed for investment in shares (of foreign company) is deductible under s. 57(iii) even though the shares did not yield any dividend.

Section 57(iii) only requires that the expenditure must be laid out or expended wholly and exclusively for making or earning income and not that such income must have actually been earned.

Practical 41

Dr. V. Gopinathan had made fixed deposit of Rs. 10 lacs in a bank on which he received interest of Rs.80,000. He had also borrowed Rs. 5 lacs from the same bank on the security of the deposit and was liable to pay Rs. 50,000 by way of interest to the bank. He, therefore, offered the difference Rs. 30,000 as income from other sources. Is this correct?

Solution

The interest income from deposit in the bank is assessable under the head "Income from Other Sources". The deduction under section 57(iii) admissible against this income is any expenditure laid out or expended wholly and exclusively for the purpose of making or earning such income. However, the interest paid on the borrowing of Rs. 5 Lacs cannot be said to have incurred for earning interest on deposit of Rs. 10 Lacs. This has been held by the Supreme Court in **CIT v. Dr. V. Gopinathan (2001) 248 ITR 449.** Therefore, in this case, the full sum of Rs. 80,000 shall be taxed under the head "Income from Other Sources" instead of difference of Rs. 30,000.

Reader's Note:

(C) Deduction under Family Pension [Section 57(iia)]

As per provision of this section, in the case of income in the nature of family pension, a deduction of a sum equal to 1/3rd of such income or Rs.15,000, whichever is less is allowable.

Explanation.—For the purposes of this clause, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death ;

7.17 AMOUNT NOT DEDUCTIBLE

Section:- 58

The following are not deductible by virtue of section 58:

(A) Personal expenses

Any personal expenditure of the assessee.

(B) Interest

Any interest chargeable under the Act which is payable outside India on which tax has not been deducted at source.

(C) Salary

Any payment chargeable under the head "Salaries" and payable outside India is not deductible if tax has not been paid or deducted therefrom.

(D) Amount specified by section 40(a)(ia)

With effect from A.Y. 2018-19, any amount specified under section 40(a)(ia) (i.e. 30% of sum payable to a resident for which there is a default by taxpayer under TDS provisions) is not deductible while calculating income under the head "Income from other sources" also.

(E) Wealth-Tax

Any sum paid on account of wealth-tax.

(F) Amount specified by section 40A

Any amount specified by section 40A is not deductible while calculating income under the head "Income from other sources".

(G) Expenditure in respect of royalty and technical fees received by a foreign company

In the case of foreign company, expenditure in respect of royalties and technical service fees as specified by section 44D.

7.18 DEEMED INCOME

Section:- 59

The provisions of section 41(1) shall apply, so far as may be, in computing the income of an assessee under the head "IFOS", as they apply in computing the income of an assessee under the head "PGBP".

7.19 CRITICAL JUDICIAL RULINGS IN QUESTION – ANSWER FORMAT

Case Study 1

Under section 2(22), dividend does not include any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a "substantial part of the business" of the company. What can be the test(s) to determine "substantial part of the business" of lending company?

Solution

This question came up before the **Bombay High Court in CIT v. Parle Plastics Ltd. (2011) 332 ITR 63.**

In this case, 42% of the total assets of the lending company were deployed by it by way of loans and advances. Further, if the income earned by way of interest is excluded, the other business had resulted in a net loss. These factors were considered in concluding that lending of money was a substantial part of the business of the company.

The expression used in the exclusion provision of section 2(22) is "substantial part of the business". Sometimes, a portion which contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be termed as a substantial part of the business. Similarly, a portion which is relatively small as compared to the total turnover, but generates a large portion, say more than 50% of the total profit of the company, may also be a substantial part of its business.

Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of manpower used for a particular part of the business in relation to the total manpower or work force of the company may be required to be taken into consideration for determining the substantial part of business. The capital employed for a specific division of a company in comparison to total capital employed may also be relevant to determine whether the part of the business constitutes a substantial part.

Reader's Note:

Case Study 2

M/s **Tuticorin Alkali Chemicals and Fertilisers Ltd.** (formerly known as Tuticorin Alkali Ltd.) was incorporated on 3rd Dec., 1971 for the purpose of manufacturing heavy chemicals such as ammonium chloride and soda ash. The trial production of the factories of the company commenced on 30th June, 1982. For the purpose of setting up of the factories, the company had taken term loans from various banks and financial institutions. That part of the borrowed funds which was not immediately required by the company was kept invested in short-term deposits with banks. Such investments were specifically permitted by the memorandum and articles of association of the company.

It claimed that according to the accepted accounting practice, interest and finance charges along with other pre-production expenses will have to be capitalised, and that, therefore, the interest income on short-term deposits with banks should go to reduce the pre-production expenses, which would ultimately be capitalised.

Therefore, it had not offered interest income on short-term deposit as income. The ITO rejected the claim of assessee. Discuss the stand taken by company vis-à-vis that of ITO.

Solution

In Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC), it was held that considering the section 4 read with section 14 of the Act, interest earned on short-term investment of funds borrowed for setting up of factory during construction of factory before commencement of business has to be assessed as income from other sources and it cannot be held to be non-taxable on the ground that it would go to reduce interest on borrowed amount which would be capitalized.

It was further observed by the Supreme Court that taxability of receipt and allowability of deduction are to be judged on the basis of provisions of tax laws and not in accordance with accountancy practice. Accounting practice cannot override section 56 or any other provisions of the Act.

Therefore, the claim of assessee was correctly rejected by ITO.

Reader's Note:

Case Study 3

Karnal Co-operative Sugar Mills Ltd. (assessee) made deposits with Bank to open letter of credit for the purchase of plant and machinery in terms of agreement with the supplier and earned interest thereon. The assessee reduced such interest income from the cost of plant and machinery and not offered to tax. Is tax treatment adopted by assessee in respect of interest income is correct?

Solution

Supreme Court in case of **CIT v. Karnal Co-operative Sugar Mills Ltd. [2001] 118 Taxman 489** made following observation:

"In the present case, the assessee had deposited money to open a letter of credit for the purchase of the machinery required for setting up its plant in terms of the assessee's agreement with the supplier. It was on the money so deposited that some interest has been earned.

This is, therefore, not a case where any surplus share capital money which is lying idle has been deposited in the bank for the purpose of earning interest.

The deposit of money in the present case is directly linked with the purchase of plant and machinery. Hence, any income earned on such deposit is incidental to the acquisition of assets for the setting up of the plant and machinery.

In this view of the matter the ratio laid down by this Court in Tuticorin Alkali Chemicals & Fertilizers Ltd. vs. CIT (1997) 227 ITR 172 (SC) will not be attracted.

The more appropriate decision in the factual situation in the present case is in CIT vs. Bokaro Steel Ltd. (1999) 236 ITR 315 (SC).

Therefore, the tax treatment adopted by assessee in respect of interest income is correct.

Reader's Note:

Case Study 4

VijayaLaxmi Sugar Mills Ltd. is under liquidation. During the year under consideration, it earned interest on deposits made by liquidator out of monies realized from the sale of assets of the company. It also incurred expenditure on salary, legal fees, travelling etc.

Based on the above facts, answer following questions:

(a) What shall be the appropriate head for taxing the interest income?

(b) Can various expenditure incurred on salary, legal fees, travelling, stamp, postage etc. be claimed against such interest income?

Solution

Supreme Court in case of **VijayaLaxmi Sugar Mills Ltd. V. CIT (1991) 191 ITR 641** answered as under:

(a) Since, liquidator was merely realizing the assets of the company and not carrying on any business of the company therefore, interest on deposits made by liquidator out monies realized from sale of the assets of the company in liquidation, shall be assessable as "Income from other sources".

(b) It was further held that salaries, legal fees, traveling expenses and other liquidation expenses incurred by the liquidator cannot be said to have been incurred for the purpose of earning such income. Therefore, such expenditure cannot be allowed u/s 57(iii) against such interest income.

Reader's Note:

Case Study 5

Rajkumar is a proprietor of M/s. Premier Engineering Corporation (PEC) which is in business of manufacturing customized kitchen equipment. He is also the Managing Director and held nearly 65% of the paid-up share capital of Continental Equipment India (P) Ltd. (CEIPL). A substantial part of the business of "PEC" is obtained through "CEIPL". For this purpose, "CEIPL" passed on the advance received from its customers to "PEC" to execute the job work entrusted to him.

The Assessing Officer held that the advance money received by Rajkumar in "PEC" is in the nature of loan given by "CEIPL" to him and accordingly is deemed dividend within the meaning of provisions of section 2(22)(e) of the Income-tax Act, 1961. The Assessing Officer, therefore made the addition by treating advance money as the deemed dividend income of Rajkumar. Examine whether the action of the Assessing Officer is tenable in law.

Solution

The Delhi High Court in case of **CIT v. Rajkumar (2009) 318 ITR 462** made following observations:

It is clear that sub-cl. (e) of s. 2(22), plainly seeks to bring within the tax net accumulated profits which are distributed by closely-held companies to its shareholders in the form of loans.

The purpose being that persons who manage such closely-held companies should not arrange their affairs in a manner that they assist the shareholders in avoiding the payment of taxes by having these companies pay or distribute, what would legitimately be dividend in the hands of the shareholders, money in the form of an advance or loan.

If this purpose is kept in mind then, the word 'advance' has to be read in conjunction with the word 'loan'. Usually attributes of a loan are that it involves positive act of lending coupled with acceptance by the other side of the money as loan : it generally carries an interest and there is an obligation of repayment. On the other hand, in its widest meaning the term 'advance' may or may not include lending. The word 'advance' if not found in the company of or in conjunction with a word 'loan' may or may not include the obligation of repayment. If it does then it would be a loan. Thus arises the onundrum as to what meaning one would attribute to the term 'advance'.

The rule of construction which answers this conundrum is noscitur a sociis. Keeping the aforesaid rule together with rule of purposive construction in mind the word 'advance' which appears in the company of the word 'loan' could only mean such advance which carries with it an obligation of repayment.

Therefore, trade advance which is in the nature of money transacted to give effect to a commercial transaction would not fall within the ambit of the provisions of s. 2(22)(e).

Considering the above, action of A.O. treating advance as deemed dividend is not tenable.

Reader's Note:

Case Study 6

Ambassador Travels(P) LTD is a travel agency. It was involved in the booking resorts for the customers of Holiday Resort (P) Ltd. and Ambassador Tours(India) (P) Ltd. and accordingly entered into normal business transactions as a part of its day-to-day business activities. The assessing officer, after considering the shareholding pattern, came to the conclusion that few transactions fell within the meaning of deemed dividend under section 2(22)(e). Whether the action of assessing officer is tenable in law?

Solution

The Delhi High Court, while dealing with the above facts in **CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376** held as under:

It is quite clear that the assessee was a travel agency and the above two concerns that it had dealings with, that is, M/s Holiday Resort (P) Ltd. and M/s Ambassador Tours (India) (P) Ltd. were also in the tourism business. The assessee was involved in the booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities. The financial transactions cannot in any circumstances be treated as loans or advances received by the assessee from these two concerns.

Reader's Note:

Case Study 7

Vir Vikram Vaid holds 76.26 % of equity shares of Offshore Hookup and Construction Services Pvt. Ltd. (HCSPL) He is also an executive director of the company. In his personal capacity, he is the owner of certain premises in which he was carrying on a proprietary business. Vir Vikram Vaid ceased to carry on the business of proprietary concern and thereafter let out the premises to the HCSPL. The HCSPL incurred Rs. 2.51 crores towards construction and improvement of factory premises, which it continued to use. The Assessing Officer held that the amounts spent by the HCSPL towards repair and renovation is taxable as deemed dividend in the hands of Vir Vikram Vaid following the decision of Mr. M.D. Jindal v. CIT 164 ITR 28 (Cal.)

Whether the action taken by the assessing officer is sustainable?

Solution

The Bombay High Court while dealing with the above issue in case of **CIT v. Vir Vikram Vaid (2014) 367 ITR 365** made following observations:

In the present case, no money had been paid to Vir Vikram Vaid by way of advance or loan nor was any payment made for his individual benefit.

The HCSPL spent Rs.2.51 crores towards repair and renovation on the premises owned by the Vir Vikram Vaid. There is no dispute about the fact that the HCSPL had taken rent on the aforesaid premises. Thus, it is case where the asset of the Vir Vikram Vaid may have enhanced in value by virtue of repairs and renovation in respect of which it cannot be brought within definition of the advance or loan to the shareholder. Nor can it be treated as payment by the Company on behalf of the share holder or for the individual benefit of such share holder.

Considering the above, view taken by the assessing officer is unsustainable in the eyes of law.

Reader's Note:

Case Study 8

Pradip Kumar has substantial shareholding in a private company called Sumoson Exports (P) Ltd (SEPL). He has his immovable property which was let out to SEPL. Subsequently, he permitted this property to be offered as collateral security to the Vijaya Bank for enabling the SEPL to obtain the loan from the said Bank. Consequently, board of directors passed a resolution authorizing Pradip Kumar to obtain from the SEPL interest free deposit upto Rs. 50,00,000 as and when required for making available the said property as collateral security to Vijaya Bank.

After 10 years, Pradip Kumar required funds for his personal needs and education of his son abroad. Therefore, he requested the SEPL to purchase the property or release the same so that he can sell it to some other person. On failing to do so, the SEPL gave Rs. 10,00,000 to Pradip Kumar as advance rent.

The assessing officer treated the unadjusted advance as deemed dividend under section 2(22)(e) in the hands of Pradip Kumar. Discuss the legality of the stand taken by Assessing Officer.

Solution

The Calcutta High Court in case of **Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538** made following observations:

The phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power.

In case such loan or advance is given to such shareholder as a consequence of any further consideration which is beneficial to the company received from such a shareholder, such advance or loan cannot be said to a deemed dividend within the meaning of the Act.

Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) but not to the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder.

Considering the above, stand taken by the assessing officer that said advance is deemed dividend is not correct.

Reader's Note:

Case Study 9

Manjoo and Co.(assessee) was a wholesale distributor of lotteries organized by the State of Kerala and under the distribution agreement it is entitled to certain discount on the purchase of lottery tickets. If the tickets purchased are not fully sold out by it before the draw date then loss will be to the account of the assessee.

During previous year certain unsold tickets held by Manjoo and Co. were the prize winning tickets and on production of those tickets the Lottery Directorate paid the prize money to the assessee after recovery of tax at source treating the payments as "winning from lottery".

However, assessee accounted the receipt of income in the P&L a/c as prize won from lottery, in the IT returns filed, and claimed that the prize money received from the Lottery Department represents income not assessable under the special provisions contained in s. 115BB of the IT Act but assessable as business income. The ITO however rejected the claim holding that prize money received in lottery is assessable at the special rate provided under s. 115BB and it cannot be treated as business income.

Discuss the validity of stand taken by Manjoo and Co. vis-à-vis that of ITO.

Solution

In case of **CIT v. Manjoo and Co. (2011) 335 ITR 527 (Ker),** the Counsel for the Income Department submitted as under:

The receipt of winnings from lottery for the assessee Manjoo and Co. is not on account of any physical or intellectual effort made by him and it is not "income earned" by him in business. After draw of the lottery, assessee cannot sell any ticket and the entire tickets held by him become waste paper except any prize winning ticket if held by him which if produced will entitle him for the prize money. Therefore, according to him the receipt of prize money is not in the capacity as a lottery distributor but as the holder of the lottery ticket which was prized. The Lottery Department also does not treat it as business income received by the respondent but they also treat it as prize money paid on which TDS is recovered.

The above argument of the Income Tax Department was accepted by Kerala High Court. Therefore, the stand taken by Manjoo and co, that such prizes shall be treated as business income is not tenable.

Reader's Note:

Case Study 10

What is the appropriate head of income for taxing rental income from plinths? Is it "Income from house property" or "Income from other sources"?

Solution

Punjab and Hariyana Court in case of **Sudhir Nagpal v. Income-tax Officer (2012) 349 ITR 636** referred to the Division Bench judgment in Gowardhan Das and Sons v. CIT (2007) 288 ITR 481, wherein it was observed that it is the income from property consisting of any building or land appurtenant thereto which is assessed under section 22 and not the income from renting out of open land or some kutcha plinth only.

Considering the above, the Court held that the income from letting out the plinths is assessable under section 56 as "Income from other sources" and not under the head "Income from house property".

Reader's Note:

8 – CLUBBING OF INCOME

8.1 TRANSFER OF INCOME WHERE THERE IS NO TRANSFER OF ASSETS

Section:- 60

If any person transfers only income where there is no transfer of assets, then such income shall be included in the total income of the transferor

Practical 1

Mr. Vatsan has transferred, through a duly registered document, the income arising from a godown to his son, without transferring the godown. In whose hands will the rental income from godown be charged?

Solution

Section 60 provides that where there is transfer of income from an asset without transfer of the asset itself, such income shall be included in the total income of the transferor. Hence, the rental income derived from the godown shall be included in the total income of Mr. Vatsan.

Readers Note:

8.2 REVOCABLE TRANSFER OF ASSETS

Section:- 61, 62, 63

(1) Section 61

All income arising to any person by virtue of a revocable transfer of assets shall be chargeable to tax as the income of transferor and therefore, it shall be included in his total income.

(2) Section 63

Transfer shall be deemed to be revocable if-

(a) it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor; or

(b) it, in any way, gives the transferor a right to re-assume power, directly or indirectly, over the whole or any part of the income or assets.

(3) Section 62

Transfer shall be taken as irrevocable in following cases and accordingly provisions of section 61 shall not apply.

(a) If the transfer is by way of trust which is not revocable during the lifetime of the beneficiary

(b) If the transfer is otherwise than by way of trust which is not revocable during the lifetime of the transferee

(c) If transfer is made prior to April 1, 1961, which is not revocable for a period exceeding 6 years.

Benefit of section 62 shall not be available in following cases (i.e. the clubbing provisions as discussed in section 61 shall continue to apply)

(a) The transferor derives any direct or indirect benefit from the income of transferred assets

(b) As and when the power to revoke transfer arises.

Practical 2

Mr. Jaggi has transferred following income yielding assets as under:

(a) A commercial property in favour of charitable trust which is not revocable.

(b) A residential property in favour of Mr. Pranay his friend, which is not revocable during the lifetime of Mr. Pranay.

Whether clubbing provision shall be attracted in the hands of Mr. Jaggi?

Solution

Considering the provisions of section 62, clubbing provision shall not be attracted in the hands of Mr. Jaggi provided Mr. Jaggi does not derive directly or indirectly the benefit from the income of transferred assets.

Readers Note:

8.3 REMUNERATION OF SPOUSE TO BE CLUBBED IN THE HANDS OF INDIVIDUAL

Section:- 64(1)(ii)

If following conditions are satisfied then, then the income derived by the spouse bay way of salary, commission, fees or any other form of remuneration shall be clubbed in the hands of taxpayer.

(1) The taxpayer is an individual.

(2) The taxpayer has a substantial interest in a concern.

For this purpose, an individual shall be deemed to have substantial interest in a concern if he (individually or along with his one or more relatives)

(a) beneficially holds equity shares carrying not less than 20 percent voting power in the case of a company or

(b) is entitled to not less than 20 per cent of the profits, in the case of a concern other than a company, at any time during the previous year.

["Relative", in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual-section sec. 2(41)]

(3) Spouse of the individual derives, directly or indirectly, income by way of salary, commission, fees or any other form of remuneration whether in cash or in kind from such concern.

Exception:

Aforementioned clubbing provision shall not apply in relation to any income arising to the spouse where

(a) the spouse possesses technical or professional qualifications and

(b) such income is solely attributable to the application of his or her technical or professional knowledge and experience.

How to club the remuneration where both the husband and wife have substantial interest in the concern and both are in receipt of the remuneration from such concern without technical or professional qualification? – Then in such case, the remuneration shall be clubbed in in the total income of that spouse whose total income, excluding such remuneration, is greater.

Once such income is included in the total income of the either spouse, any such income arising in any subsequent year cannot be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary so to do.

8.4 INCOME FROM ASSETS TRANSFERRED TO WIFE SHALL BE CLUBBED IN THE HANDS OF INDIVIDUAL

Section:- 64(1)(iv)

If following conditions are satisfied then, then any income from transferred asset shall be clubbed in the hands of taxpayer.

(1) The taxpayer is an individual.
(2) The taxpayer has transferred an asset (other than a house property), directly or indirectly, to the spouse.
(3) Such transfer is made otherwise than (a) for adequate consideration, or (b) in connection with an agreement to live apart.

In following cases, clubbing is not attracted if –

(1) asset is transferred for an adequate consideration.
(2) asset is transferred in connection with an agreement to live apart.
(3) asset is transferred before marriage.
(4) on the date of accrual of income, marriage does not subsist..
(5) asset is acquired out of the saving from pin money (i.e. money given to the wife by her husband for household expenses)

Manner of clubbing when asset transferred to a spouse are invested in any business (except capital contribution as a partner in the firm)

Where the assets transferred by an individual to his spouse are invested by the spouse in any business, then following amount shall be clubbed:

$$\text{Income from business} \times \left(\frac{\text{Amount invested in the business out of the transferred assets on the first day of the previous year}}{\text{Total investment in the business as on the first day of previous year}} \right)$$

When transferred asset is invested in the firm as a capital contribution.

Then in this case, interest on capital shall be clubbed.

8.5 WHEN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS TRANSFERRED TO SON'S WIFE

Section:- 64(1)(vi)

If following conditions are satisfied, then any income from transferred asset shall be clubbed in the hands of taxpayer.

Conditions

(1) The taxpayer is an individual.
(2) The taxpayer has transferred an asset, directly or indirectly, to son's wife.
(3) Such transfer is made otherwise than for adequate consideration.

In following cases, clubbing is not attracted if –

(1) asset is transferred for an adequate consideration.
(2) asset is transferred before son's marriage.

8.6 WHEN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SPOUSE

Section:- 64(1)(vii)

Conditions –

If following conditions are satisfied, then any income from transferred asset (to the extent of benefit to spouse) shall be clubbed in the hands of taxpayer.

(1) The taxpayer is an individual.
(2) The taxpayer has transferred an asset, directly or indirectly, to a person or an association of persons.
(3) Such transfer is made otherwise than for adequate consideration.
(4) Such transfer is for the immediate or deferred benefit of his/her spouse.

8.7 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SON'S WIFE

Section:- 64(1)(viii)

Conditions –

If following conditions are satisfied, then any income from transferred asset (to the extent of benefit to son's wife) shall be clubbed in the hands of taxpayer.

(1) The taxpayer is an individual.
(2) The taxpayer has transferred an asset, directly or indirectly, to a person or an association of persons.
(3) Such transfer is made otherwise than for adequate consideration.
(4) Such transfer is for the immediate or deferred benefit of his/her son's wife.

8.8 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SON'S WIFE

Section:- 64(1A)

In computing total income of any individual, all income which arises or accrues to the minor shall be clubbed.

(1) Manner of Clubbing :-

(a) Where the marriage of parent subsists:-The income of minor shall be included in the income of that parent whose total income [excluding the income includible under section 64(1A)] is greater

(b) Where the marriage of the parents does not subsist: The income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.

Where any such income is once included in the total income of either parent, any such income arising in any succeeding year shall not be included in the total income 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.

(2) When clubbing is not attracted in respect of minor's income

In the cases given below, clubbing provision of section 64(1A) is not applicable —

(1) Income of minor child suffering from any disability of the nature specified under section 80U.

(2) Income accrues or arises to minor child on account of any manual work.

(3) Income accrues or arises to minor child on account of any activity involving application of his skill, talent or specialised knowledge and experience.

(3) Exemption under section 10(32)

In case the income of individual includes the income of his minor child in terms of section 64(1A), such individual shall be entitled to exemption of a maximum of Rs. 1,500, in respect of each minor child.

8.9 CONVERSION OF SELF-ACQUIRED PROPERTY INTO JOINT FAMILY PROPERTY AND SUBSEQUENT PARTITION

Section:- 64(1A)

The following transactions falls under this section:

(a) Where an individual, being a member of a Hindu undivided family, converts his self-acquired property into property belonging to the family through the act of impressing such property with the character of joint family property or throws such property into common stock of the family.

(b) Where an individual transfers his self-acquired property, directly or indirectly, to the family otherwise than for adequate consideration.

Clubbing of income before partition

Income from the abovementioned property shall be chargeable to tax in the hands of the transferor.

Clubbing of income after partition

If the property converted or transferred by an individual is subsequently transferred amongst the members of the family, the income derived from such converted property, as is received by the spouse of the transferor will be included in the income of the transferor.

Meaning of Property

Property includes any interest in property, movable or immovable, the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

8.10 RECOVERY OF TAX

Section:- 65

(1) As discussed above, incomes belonging to other persons (recipient of income) shall be clubbed in the total income of the assessee.
(2) Similarly, under section 27(i), a person is 'deemed' as owner of a house property and therefore, liable to tax in respect of house property income earned by other persons(recipient of income)
(3) By virtue of section 65 of the Act, the assessing officer may serve a notice of demand to the recipient of income to pay proportionate tax attributable in respect of income included in the income of assessee

8.11 OTHER POINTS TO BE KEPT IN MIND WHILE CLUBBING THE INCOME

(1) Income arising to the transferee from accretion of property or from accumulated income is not liable to be clubbed in the hands of transferor **[CIT vs. M.S.S.Rajan 252 ITR 126(Madras HC)]**
(2) The negative income is also liable to be clubbed

8.12 CRITICAL JUDICIAL RULINGS IN QUESTION – ANSWER FORMAT

Case Study 1

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of Rs.10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands. Discuss the correctness of the action of the Assessing Officer.

Solution

The issue under consideration is the interpretation of terms "professional qualifications" and "knowledge" as appearing in proviso to section 64(1). Following are the significant observation of Madras High Court in the case of CIT v. Smt. R. Bharati (1999) 240 ITR 697.

(a) These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc.

(b) Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

(c) The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill.

A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii). Applying the rationale of the Madras High Court ruling, a model, having skill, competence and experience in her line can be considered as a professional. Hence, the action of the Assessing Officer is not in accordance with law

Reader's Note:

9 – SET OFF AND CARRY OF LOSSES

9.1 PROCESS OF SET OFF AND CARRY FORWARD OF LOSSES

Consider three steps to be followed sequentially.

(1) Step 1 – Inter – Source set-off within same head subject to restrictions under section 70
(2) Step 2 – Inter-head set-off subject to restrictions under section 71
(3) Step 3 – Carry forward of losses.

9.2 INTER-SOURCE SET-OFF

Section:- 70

(1) Rule

If the net result for any assessment year, in respect of any source under any head of income, is a loss, then, the assessee shall be entitled to set off the amount of such loss against his income from any other source under the same head.

(2) Exceptions

(a) Loss in a speculation business can be set off only against the profit in a speculation business.
(b) Long-term capital loss can be set off only against long-term capital gain.
(c) Loss incurred in the business of owning and maintaining race horses cannot be set off against any income except income from such business.
(d) Loss from specified business referred to in section 35AD can be set-off only against profits and gains from other specified business.
(e) Loss cannot be set off against income referred to in section 115BB, 115BBDA and 115BBE.

(3) Other points

(a) If income from a particular source is exempt from tax, loss from such source cannot be set off against income chargeable to tax.
(b) If there is income from one source and loss from another source within the same head of income, then, one **has to** set off the loss against the income. In short, set-off is not optional, even, partial set-off is also not allowed.

9.3 INTER-HEAD ADJUSTMENT

Section:- 71

(1) Rule

Where the net result of computation made for any assessment year in respect of any head of income is a loss, then, the assessee shall be entitled to set off such loss against his income from other heads.

(2) Exceptions

The following are the exceptions to the aforesaid rule—

(a) Loss in a speculation business

(b) Loss under the head "Capital gains"

(c) Loss from the activity of owning and maintaining race horses

(d) Loss from business or profession cannot be set off against income under the head "Salaries".

(e) Loss from specified business referred to in section 35AD

(f) Loss under the head "House Property" exceeding Rs. 2,00,000 cannot be set off against income under other heads of income.

(g) Loss cannot be set off against income referred to in section 115BB, 115BBDA and 115BBE.

(3) Other points

The following points should be considered—

(a) No order of priority is given under the Act for set-off.

(b) If there is income from one head and loss from another head, then, one **has to** set off the loss against the other head income. In short, set-off is not optional, even, partial set-off is also not allowed.

9.4 CARRY FORWARD OF LOSSES

Section:- 71B, 72, 73, 73A, 74 and 74A(3)

If a loss cannot be set off under section 70 or section 71, because of absence or inadequacy of the income of the same year, it can be carried forward subject to following provisions:

(1) Loss under the head "Income from house property" **[section 71B]**

(2) Loss under the head "Profits and gains of business or profession" **[section 72]**

(3) Loss in a speculation business **[section 73]**

(4) Loss in a specified business **[section 73A]**

(5) Loss under the head "Capital gains" **[section 74]**

(6) Loss from the activity of owning and maintaining race horses **[section 74A(3)]**.

Note: Remaining losses cannot be carried forward.

(1) Carry forward and set off of loss from house property [Section 71B]

Section 71B provides that where the assessee incurs loss under the head "Income from house property" and such loss cannot be wholly set off against income from any other heads of income in the same assessment year, then such unabsorbed loss shall be carried forward to the following assessment year and thereafter it can be set off against income from house property of subsequent assessment year.

However, such carry forward and set-off cannot be more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

(2) Carry forward and set off of business loss other than speculation loss [Section 72]

Section 72 provides that where the assessee incurs loss under the head "Profits and gains of business or profession" (other than loss in a speculation business) and such loss cannot be wholly set off against income from any other heads of income (subject to the limitation discussed under section 71 of the Act) in the same assessment year, then such unabsorbed loss shall be carried forward to the following assessment year and thereafter it can be set off against income from "Profits and gains of any business or profession".

However, such carry forward and set-off cannot be more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Special provision for the business discontinued in the circumstances stated in section 33B:

The unabsorbed loss sustained in a business which is discontinued in the circumstances stated in section 33B, is eligible for being carried forward and set off against profits of the re-established, re-constructed or revived business up to **a period of 8 years, reckoned from the year in which the business was re-established, re-constructed or revived by the assessee.**

Section 78(2) provides that where any person carrying on any business or profession has been succeeded by another person then another person cannot carry forward and set off the loss of such business or profession against his income.

However, there is one exception to this rule: - If succession takes place by way of inheritance, then successor can claim set off and carry forward of the loss from business or profession.

Where legal heirs of a deceased-proprietor enters into partnership and carries on the same business in the same premises under the same trade name, there is succession by inheritance as contemplated in section 78(2). As a result, assessee-firm is entitled to carry forward and set-off of the deceased's business loss against its income for subsequent years**– CIT v. Madhukant M. Mehta (SC).**

(3) Carry forward and set off of speculation loss [Section 73]

Section 73 provides that where the loss is computed in respect of a speculation business and such loss cannot be wholly set off against income from any other speculation business in the same assessment year, then such unabsorbed loss shall be carried forward to the following assessment year and thereafter it can be set off against income from speculation business of subsequent assessment year.

However, such carry forward and set-off cannot be more than four assessment years immediately succeeding the assessment year for which the loss was first computed.

(4) Carry forward and set off of losses by specified business [section 73A]

Section 73A provides that where the loss is computed in respect of specified business referred to in section 35AD and such loss cannot be wholly set off against income from any other specified business in the same assessment year, then such unabsorbed loss shall be carried forward to the following assessment year and thereafter it can be set off against income from specified business of subsequent assessment year.

However, such carry forward and set off is for unlimited time frame.

(5) Carry forward and set-off of capital loss [Section 74]

Where the net result of computation under the head "Capital gains" is a loss, such loss shall be carried forward to the following assessment year and-

(1) Long-term capital loss can be set off only against long-term capital gain arising in subsequent assessment year(s);

(2) Short-term capital loss can be set off against short-term gain or long-term capital gain arising in subsequent assessment year(s).

However, such carry forward and set off in subsequent assessment years cannot be more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

(6) Carry forward and set off of loss from activity of owning and maintaining of race horses [Section 74A(3)]

Section 74A(3) provides that where the assessee (being the owner of horses maintained by him for running in horse races) incurs loss from the activity of owning and maintaining race horses and such loss cannot be wholly set off against such income in the same assessment year, then such unabsorbed loss shall be carried forward to the following assessment year and thereafter it can be set off against income from the activity of owning and maintaining race horses.

However, such carry forward and set-off cannot be more than four assessment years immediately succeeding the assessment year for which the loss was first computed.

For availing benefit of set off in subsequent year, the activity of owning and maintaining race horses shall be continued for such subsequent year

9.5 SUBMISSION OF RETURN FOR LOSSES

Section:- 80

A loss sustained by the assessee in any previous year under the

(1) Section 72(1) - Profits and Gains of business or profession

(2) Section 73(2) - Speculation business

(3) Section 73A(2)-Specified business (Amendment by Finance Act, 2016)

(4) Section 74A(3) - Owning and maintaining of horse races

(5) Section 74(3) - Capital Gains

can be carried forward only if the return is furnished within the time allowed u/s. 139(1).

9.6 TAX TREATMENT OF UNABSORBED DEPRECIATION, CAPITAL EXPENDITURE ON SCIENTIFIC RESEARCH AND FAMILY PLANNING EXPENDITURE

Section:- 32(2)

If profits under the head "PGBP" are not sufficient to absorb the-

(1) current depreciation;

(2) current scientific research expenditure;

(3) current year family planning expenditure;

then, same shall be treated as unabsorbed depreciation and its treatment shall be governed by section 32(2) and not by section 72.

Following points merit consideration while dealing with unabsorbed depreciation:-

(1) Such unabsorbed depreciation can be set off against every head income.
(2) Thereafter, it still remains then same shall be carried forward.
(3) Such unabsorbed depreciation shall be carried forward for unlimited period.
(4) Since unabsorbed depreciation is governed by section 32(2), it can be carried forward even if return has not been filed within the due date under section 139(1).
(5) In subsequent years, it can be adjusted against every head of income.
(6) The order of set off shall be:
    (a) Current depreciation
    (b) Brought forward business loss
    (c) Unabsorbed depreciation

9.7 LOSS ON SALE OF SHARES, SECURITIES OR UNITS

Section:- 94(7)

Refer Module I – Chapter No. 7

9.8 LOSS ARISING IN THE CASE OF BONUS STRIPPING

Section:- 94(8)

Refer Module I – Chapter No. 7

9.9 CARRY FORWARD AND SET OFF OF LOSSES IN THE CASES OF PARTNERSHIP FIRMS

Section:- 78

Refer Module II – Chapter No. 12

9.10 CARRY FORWARD AND SET OFF OF LOSSES IN THE CASES OF CERTAIN COMPANIES

Section:- 79

Refer Module II – Chapter No. 15

9.11 CARRY FORWARD AND SET-OFF OF LOSS AND DEPRECIATION - WHEN PERMISSIBLE IN THE HANDS OF AMALGAMATED COMPANY

Section:- 72A

Refer Module III – Chapter No. 37

9.12 SET OFF OF LOSSES OF A BANKING COMPANY AGAINST THE PROFIT OF A BANKING INSTITUTION UNDER A SCHEME OF AMALGAMATION

Section:- 72AA

Refer Module III – Chapter No. 38

9.13 SET OFF OF LOSSES OF A PROPERIETORSHIP OR PARTNERSHIP BY COMPANY

Section:- 72A(6)

Refer Module III – Chapter No. 35 and 36

9.14 SET OFF OF LOSSES ON CONVERSION OF A COMPANY INTO LLP

Section:- 72A(6A)

Refer Module III – Chapter No. 42

9.15 CARRY FORWARD AND SET OFF OF BUSINESS LOSSES AND UNABSORBED DEPRECIATION OF THE DEMERGED COMPANY

Section:- 72A(4) and 72A(5)

Refer Module III – Chapter No. 39

9.16 CARRY FORWARD AND SET-OFF OF LOSSES AND DEPRECIATION – WHEN PERMISSIBLE IN THE HANDS OF AMALGAMATED / RESULTING CO-OPERATIVE BANKS

Section:- 72AB

Refer Module III – Chapter No. 40

9.17 CRITICAL JUDICIAL RULINGS IN QUESTION – ANSWER FORMAT

Case Study 1

Mr. Pramod Mittal was previously a partner in a firm. As per the dissolution deed of the partnership firm, with effect from 18th September, 2004, he took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2) and the decisions of the Supreme Court in CIT v. Madhukant M. Mehta (2001)

247 ITR 805 (SC), claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was rejected by the Assessing Officer. Whether action of assessing officer is correct?

Solution

Delhi High Court in case of Pramod Mittal v. CIT (2013) 356 ITR 456 observed that upon dissolution, the partnership firm ceased to exist. Also, the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment. As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 18th September, 2004). Thereafter, the income of the sole-proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The High Court opined that the decision in Madhukant M. Mehta's case cannot be applied since this is not a case of succession by inheritance.

Therefore, the loss suffered by the erstwhile partnership firm before dissolution of the firm cannot be carried forward by the successor sole-proprietor, since it is not a case of succession by inheritance. The assessee sole-proprietor is, therefore, not entitled to setoff the loss of the erstwhile partnership firm against his income. Hence, action taken by the assessing officer is justified in the eyes of law.

Reader's Note:

10 – DEDUCTION FROM GROSS TOTAL INCOME
UNIT A: DEDUCTIONS UNDER SECTION 80IA & 80IAB

10.1 INFRASTRUCTURE FACILITIES

Section:- 80-IA(4)(i)

(1) Eligible business

Any enterprise carrying on the business of developing or operating and maintaining or developing, operating and maintaining any infrastructure facility.

(2) Conditions

Any enterprise, for availing deduction with reference to the profits of the business relating to infrastructure facility, shall fulfill all the following conditions:

(i) The enterprise should be owned by a company registered in India or a consortium of such companies or by an authority or a Board or a Corporation or any other body established or constituted under any Central or State Act;

(ii) The enterprise should enter into an agreement with Central/State Government or a local authority or any other statutory body for developing or operating and maintaining or developing, operating and maintaining a new infrastructure facility;

(iii) The enterprise has started its operations and maintenance on or after 01.04.1995.

(iv) The benefit of deduction under this section shall not be available to any enterprise which starts the development or operation and maintenance of the infrastructure facility on or after the 1st day of April, 2017.

(v) For the purpose of this clause:

"Infrastructure facility" means	Period of Deduction
A road including toll road, a bridge or a rail system	Any 10 consecutive years out of 20 years beginning from the year in which the enterprise develops and begins to operate any infrastructure facility.
A highway project including housing or other activities being an integral part of the highway project	
A water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system	
A port, airport, inland waterway, inland port or navigational channel in the sea	Any 10 consecutive years out of 15 years beginning from the year in which the enterprise develops and begins to operate any infrastructure facility.

(vi) Special condition for housing projects:- The deduction shall be subject to the condition that the profits of such housing or other development activities shall be transferred to a special reserve account and shall be utilized for the highways projects (excluding housing and other activities) within a period of three years following the year in which transfer to reserve took place. Any amount remaining unutilised shall be chargeable to tax as income of the year in which such transfer to reserve account took place.

(3) Quantum of Deduction

100% of profits derived from eligible undertaking

(4) Additional Points

(i) Where an infrastructure facility is transferred by an enterprise which developed such infrastructure facility to another enterprise for the purpose of operating and maintaining the infrastructure facility on its behalf in accordance with the agreement with the Central Government, State Government, local authority or statutory body, the provisions of this section shall apply to the transferee enterprise for the unexpired period.

(ii) For the purpose of this section, widening of an existing road by constructing additional lanes as a part of a highway project shall be regarded as a new infrastructure facility. However, simply relaying of an existing road shall not be considered as a new infrastructure facility - ***Circular 4/2010 dated 18.05.2010.***

(iii) Effluent treatment and conveyance system is a part of water treatment system and therefore same would qualify as an infrastructure facility for the purpose of section 80IA- ***Circular 1/2006 dated 12.1.2006.***

(iv) Structures at the ports for storage, loading, unloading etc. will be included in the definition of 'port' for this purpose if the concerned port authority has issued a certificate to that effect - ***Circular 10/2005 dated 16.12.2005.***

10.2 Telecommunication Services

Section:- 80-IA(4)(ii)

(1) Eligible Business

Any undertaking providing telecommunication services whether basic or cellular including radio paging, domestic satellite service, network of trunking, broadband network and internet services.

(2) Conditions

(i) The undertaking is not formed by splitting up or reconstruction of existing unit.

Exception: This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(ii) Further, undertaking should not be set up by the transfer of old plant and machinery. However, following two cases old machinery is permitted:

Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

Case2:- *Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.*

(iii) The operations of the eligible business should have been started on or after 01.04.1995, but on or before 31.03.2005.

(3) Quantum and period of deduction

100% of profits derived for the first 5 consecutive assessment years and 30% of profits in the next 5 consecutive assessment years out of 15 years.

10.3 UNDERTAKING WHICH DEVELOPS, DEVELOPS AND OPERATES OR MAINTAINS AND OPERATES AN INDUSTRIAL PARK NOTIFIED BY THE CENTRAL GOVERNMENT

Section:- 80-IA(4)(iii)

Any undertaking, which develops, develops and operates or maintains and operates an industrial park notified by the Central Government.

(1) Conditions

The operations of the undertaking should have started on or after 01.04.1997, but on or before 31.03.2011.

(2) Quantum and period of deductions

100% of profits derived for any 10 consecutive assessment years out of 15 years beginning from the year of operation.

(3) Additional Points

Where an undertaking develops an industrial park or a special economic zone and transfers the operation and maintenance of such industrial park or such special economic zone, to another undertaking, then deduction shall be allowed to such transferee undertaking for the remaining period in the ten consecutive assessment years.

10.4 POWER GENERATION

Section:- 80-IA(4)(iv)

(1) Eligible Business

(i) An undertaking set up in any part of India for the generation or generation and distribution of power on or after 01.04.1993 but on or before 31.03.2017.

(ii) An undertaking, which starts transmission or distribution of power by laying a network of new transmission or distribution lines on or after 01.04.1999 but on or before 31.03.2017

(iii) An undertaking which undertakes substantial renovation and modernization of the existing network of transmission or distribution lines on or after 01.04.2004 but on or before 31.03.2017.

"Substantial renovation and modernization" means an increase in the plant and machinery in the network of transmission or distribution lines by atleast 50% of the book value of such plant and machinery as on the 01.04.2004.

(2) Conditions

(i) The undertaking is not formed by splitting up or reconstruction of existing unit.

Exception: This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(ii) Further, undertaking should not be set up by the transfer of old plant and machinery. However, following two cases old machinery is permitted:

Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

Case2:- *Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.*

(3) Quantum and period of deduction

100% of profits derived for any 10 consecutive assessment years out of 15 years, beginning from the year of operation.

10.5 RECONSTRUCTION OR REVIVAL OF POWER GENERATING PLANT

Section:- 80-IA(4)(v)

(1) Eligible Business

An undertaking owned by an Indian company and set up for reconstruction or revival of power generating plants

(2) Conditions

Sec. 80-IA provides for deduction to an undertaking owned by an Indian company and set up for reconstruction or revival of power generating plant, where such:

(i) Indian company is formed before 30.11.2005, with majority equity participation by public sector companies for the purposes 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

(iii) Undertaking begins to generate or transmit or distribute power before 31.03.2011.

(3) Quantum and Period of Deduction

100% of profits derived for any 10 consecutive assessment years out of 15 years, beginning from the year of operation.

10.6 COMMON POINTS FOR THE PURPOSE OF DEDUCTION UNDER SECTION 80-IA

Section:- 80-IA(5) to (12)

(1) Determination of quantum of deduction

Determination of quantum of deduction: Section 80 IA (5) provides that "Notwithstanding anything contained in any other provision of this Act, for the purpose of determining the **"quantum of deduction** under section 80-IA for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, the profits and gains from the eligible business **shall be computed as if such eligible business were the only source of income of the assessee** during the previous year relevant to the initial assessment year and to even subsequent assessment year up to and including the assessment year for which the determination is to be made.

(2) Audit of accounts

The deduction shall be allowed only if the accounts are audited by an accountant and audit report in prescribed form has been furnished along with the return of income.

(3) Power of A.O. to recompute profit of eligible business (Inter-Unit Transfer)

Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee; or any goods or services held for any other business are transferred to the eligible business and in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits of eligible business shall be computed by adopting market value for such goods or services as on the date of transfer- Sec. 80-IA(8).

However, where in the opinion of the Assessing Officer, the computation of profits and gains from the eligible business in the manner specified above presents exceptional difficulties; the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

(4) Transactions between close connection entities

Where it appears to the Assessing Officer that, owing to the close connection between the assessee carrying on the eligible business to which this section applies and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in the eligible business, the Assessing Officer shall, in computing the profits and gains of the eligible business, take the amount of profits as may be reasonably deemed to have been derived therefrom- Sec. 80-IA(10).

"Market value" in relation to any goods or service means the price that such goods or service would ordinarily fetch on sale in the open market. Where the transfer of such goods or services is a specified domestic transaction referred to in Sec. 92BA, the market value shall be the Arm's length price as defined u/s. 92F.

(5) Restriction on double deduction

Where any amount of profits and gains of an undertaking or of an enterprise is claimed and allowed under this section for any assessment year, deduction to the extent of such profits and gains shall not be allowed under any other provisions of this chapter under the heading "C.--Deductions in respect of certain incomes" and shall in no case exceed the profits and gains of such eligible business of the undertaking or enterprise.

(6) The Central Government may notify that exemption conferred by this section shall not apply to any class of industrial undertaking or enterprises with effect from such date as specified in the notification.

(7) Amalgamation and demerger

Where any undertaking which is entitled to the deduction under this section is transferred (on or before the 31st March, 2007) before the expiry of the period of deduction to another company in a scheme of amalgamation or demerger, no deduction shall be admissible to the amalgamating or demerged company, for the previous year in which the amalgamation or demerger takes place.

The benefit conferred under this section shall be available to the amalgamated or the resulting company as if amalgamation or demerger has not taken place.

(8) For removal of doubt, it is hereby declared that the intention of this section is not to give tax benefit for the persons who merely execute works contract awarded by any person including the Central or State Government.

(9) No deduction under this section shall be allowed if it has not been claimed in the return of income.

10.7 DEDUCTIONS IN RESPECT OF PROFITS AND GAINS BY AN UNDERTAKING OR ENTERPRISE ENGAGED IN DEVELOPMENT OF SPECIAL ECONOMIC ZONE

Section:- 80-IAB

(1) Eligible assessee

Developer engaged in the business of developing a SEZ notified on or after 01.04.2005. The benefit of deduction under this section shall not be available to any enterprise which starts the development or operation and maintenance of the infrastructure facility on or after the 1st day of April, 2017.

(2) Period of Deduction

The deduction shall be for a period of any 10 consecutive years out of 15 years beginning from the year in which the Special Economic Zone has been notified by the Central Government.

(3) Quantum of Deduction

100% of the profits and gains derived from the business of developing a SEZ shall be exempt.

(4) Other Points

(a) Where the undertaking in SEZ has been transferred to another assessee, the deduction under this section can be continued to be claimed by the transferee for unexpired period of ten years.

(b) The other conditions with reference to set off of loss of eligible undertaking, audit report, filing of return, restriction on amalgamation or demerger, restriction on double deduction, transactions between associated entities are similar to the provisions as discussed u/s. 80-IA.

UNIT B: DEDUCTIONS UNDER SECTION 80IB

10.8 INDUSTRIAL UNDERTAKING

Section:- 80 IB(2)

(1) Conditions

(i) The undertaking is not formed by splitting up or reconstruction of existing unit.

Exception: This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(ii) Further, undertaking should not be set up by the transfer of old plant and machinery. However, following two cases old machinery is permitted:

Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

Case2:- Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.

(iii) Undertaking manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule (such restriction not applicable to SSI or the unit set up in backward State), or operates one or more cold storage or plant or plants in any part of India.

(iv) Undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without aid of power.

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(2) Quantum and period of Deduction

Type of undertaking>>>> >>>>>>	**Small Scale Industrial Undertaking**	**Industrial undertaking (including cold storage set up in an industrial backward State**	**Industrial undertaking (including cold storage set up in Category A notified backward district**	**Industrial undertaking (including cold storage set up in Category B notified backward district**	**Cold chain facility for agricultural produce**	**Any other**
1. Nature of articles to be produced	Any	Any	Other than those given in Eleventh Schedule	Other than those given in Eleventh Schedule	Cold chain facility for agricultural produce	Other than those given in Eleventh Schedule
2. Time limit for commencement	Between April 1, 1991 and March 31, 2002	Between April 1, 1993 and March 31, 2004 (March 31, 2012 for an industrial undertaking in the State of Jammu and Kashmir	Between October 1, 1994 and March 31, 2004	Between October 1, 1994 and March 31, 2004	April 1, 1999 and March 31, 2004	Between April 1, 1991 and March 31, 1995
3. Quantum of deduction						
3.1 Owned by a company	30% for first 10 years	100% for first 5 years and 30% for next 5 years	100% for first 5 years and 30% for next 5 years	100% for first 3 years and 30% for next 5 years	100% for first 5 years and 30% for next 5 years	30% for first 10 years

3.2 Owned by a Co-operative Society	25% for first 12 years	100% for first 5 years and 25% for next 7 years	100% for first 5 years and 25% for next 7 years	100% for first 3 years and 25% for next 7 years	100% for first 5 years and 25% for next 7 years	25% for first 12 years
3.3 Owned by any other person	25% for first 10 years	100% for first 5 years and 25% for next 5 years	100% for first 5 years and 25% for next 5 years	100% for first 3 years and 25% for next 5 years	100% for first 5 years and 25% for next 5 years	25% for first 10 years

10.9 UNDERTAKING ENGAGED IN THE PRODUCTION AND REFINING OF MINERAL OIL

Section:- 80-IB(9)

(1) Eligible Business

Undertaking which is engaged in commercial production of mineral oil or refining of mineral oil.

(2) Conditions

(i) Undertaking is located in the North-Eastern region and has begun or begins commercial production of mineral oil before 01.04.1997.

(ii) Undertaking is located in any part of India and has begun or begins commercial production of mineral oil on or after 01.04.1997 but not later than 31st March, 2017.

However, this deduction shall not be available for blocks licensed under a contract awarded after 31.03.2011 under the New Exploration Licensing Policy or in pursuance of any law for the time being in force or by the Central or State Government in any other manner

(iii) Undertaking is engaged in refining of mineral oil and begins such refining on or after 01.10.1998 but before 31.03.2012;

(iv) Undertaking is engaged in the commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts (NELP-VIII) under the New Exploration Licensing Policy announced by the Government of India and begins commercial production of natural gas on or after 01.04.2009 but not later than 31st March, 2017;

(v) Undertaking is engaged in commercial production of natural gas in blocks licensed under the IV Round of bidding for award of exploration contracts of Coal Bed Methane blocks and begins commercial production of natural gas on or after 01.04.2009 but not later than 31st March, 2017.

For the purpose of claiming deduction, all blocks licensed under a single contract, awarded under the New Exploration Licensing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, Dt. 10.02.1999 or in pursuance of any law for the time being in force or by the Central or State Government in any other manner, shall be treated as a single “undertaking"- Explanation to this sub- section.

(3) Quantum and period of deduction

100% of the profits derived from such business for 7 consecutive years including the initial assessment year

10.10 PROCESSING, PRESERVATION AND PACKAGING OF FRUITS OR VEGETABLES….

Section:- 80-IB(11A)

(1) Eligible Business

Any assessee engaged business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains.

(2) Conditions

(i) The assessee begins to operate the above business on or after 1st April, 2001.

(ii) The benefit of this section shall not be available to an undertaking engaged in the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products if it begins to operate such business before the 1st day of April, 2009.

(3) Quantum and period of deduction

100% of profits derived for the first 5 consecutive assessment years and 25% (30% in case of a company) of profits in the next 5 consecutive assessment years.

10.11 HOSPITALS

Section:- 80-IB(11C)

(1) Eligible Business

(i) Hospital located anywhere in India other than the excluded area constructed and starts functioning at any time during the period from 01.04.2008 to 31.03.2013.

(ii) Excluded area shall mean: (i) Greater Mumbai urban agglomeration; ii) Delhi urban agglomeration; iii) Kolkata urban agglomeration; iv) Chennai urban agglomeration; v) Hyderabad urban agglomeration; vi) Bangalore urban agglomeration; vii) Ahmedabad urban agglomeration; viii) Faridabad District; ix) Gurgaon District; x) Gautam Budh Nagar District; xi) Ghaziabad District; xii) Gandhinagar District; xiii) City of Secunderabad.

(2) Conditions

(i) The hospital shall have at least 100 beds for patients;

(ii) The construction of the hospital is in accordance with the regulations or bye-laws of the local authority; and

(iii) For the purpose of this section, hospital shall be deemed to have been constructed on the date on which a completion certificate is issued by the local authority.

(3) Quantum and period of deduction

100 % of the profits derived for 5 consecutive years beginning from the initial assessment year.

10.12 COMMON POINTS APPLICABLE FOR UNDERTAKINGS COVERED U/S 80IB

All common points for the section 80 IA are equally applicable to the undertakings covered by sec. 80IB.

UNIT C: DEDUCTIONS UNDER SECTION 80IC, 80ID, 80IE

10.13 SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS OR ENTERPRISES IN CERTAIN SPECIAL CATEGORY STATES

Section:- 80-IC

(1) Eligible Business

(i) Undertaking or enterprise begins to manufacture or production of any article or thing other than those specified in Thirteenth Schedule in following Industrial Zones of (1) State of Sikkim (2) State of Uttaranchal or Himachal Pradesh (3) Any of the North-Eastern States
   (a) Export Processing Zone; or
   (b) Integrated Infrastructure Development Centre; or
   (c) Industrial Growth Centre; or
   (d) Industrial Estate; or
   (e) Industrial Park; or
   (f) Software Technology Park; or
   (g) Industrial Area; or
   (h) Theme Park,

(ii) Undertaking or enterprise has begun or begins to manufacture or production of any article or thing specified in Fourteenth Schedule in the (1) State of Sikkim (2) State of Uttaranchal or Himachal Pradesh (3) Any of the North-Eastern States.

(iii) Further, benefit under this section shall also be available to an undertaking or enterprise which has begun to manufacture or production but undertakes substantial expansion.

"Substantial expansion" for the purpose of this section means increase in the investment in the plant and machinery by at least 50% of the book value of plant and machinery (before taking depreciation in any year) as on the first day of the previous year in which substantial expansion is undertaken.

(2) Conditions

(i) The undertaking is not formed by splitting up or reconstruction of existing unit.

Exception: This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(ii) Further, undertaking should not be set up by the transfer of old plant and machinery. However, following two cases old machinery is permitted:

Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

Case 2:- Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.

(3) Quantum and period of deduction

Sr. No.	Place of Business	Period for Commencement of business or expansion	Deduction
1.	State of Sikkim	Beginning from 23.12.2002 and ending before 01.04.2007	100% of profits and gains for first 10 assessment years
2.	State of Himachal Pradesh or State of Uttranchal	Beginning from 07.01.2003 and ending before the 01.04.2012	100% of profits and gains for first 5 assessment years and thereafter 30% for Companies and 25% for other assessees for subsequent 5 assessment years.
3.	Any of the North-Eastern States	Beginning from 24.12.1997 and ending before the 01.04.2007	100% of profits and gains for first 10 assessment years

Other Points

(i) No deduction can be claimed by the assessee under any other section contained in Chapter VI-A in relation to the profits and gains of such undertaking or enterprise.

(ii) In case the assessee was already claiming the benefit u/s. 80-IB(4), the aggregate period of deduction availed by the assessee in respect of the undertaking or enterprise u/s. 80-IC or u/s. 80-IB(4) together shall not exceed 10 assessment years.

(iii) The other provisions with reference to furnishing of audit report, determination of quantum of deduction, power of assessing officer to re-compute profit in case of inter-unit transfer, restriction on double deduction, transactions between close connection activities of 80 IA are equally applicable to this section.

10.14 DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM BUSINESS OF HOTELS AND CONVENTION CENTRES IN SPECIFIED AREA

Section:- 80-ID

(1) Eligible Business

Assessees engaged in the business of:

(a) hotels located in the specified area;

(b) building, owning and operating a convention centre, located in the specified area;

(c) hotels located in the specified district having a “World Heritage Site”.

For the purpose of this section:

(a) “Specified area” means the National Capital Territory of Delhi and districts of Faridabad, Gurgaon, Gautam Budh Nagar and Ghaziabad.

(b) “Convention Centre” means a building of a prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars, being of such size and number and having such other facilities and amenities, as may be prescribed.

(c) "Hotel" means a hotel of two-star, three-star or four-star category as classified by the Central Government.

"Specified district having a World Heritage Site" are: (i) Agra; (ii) Aurangabad; (iii) Bellary; (iv) Bharatpur; (v) Bhopal; (vi) Chamoli; (vii) Chhatarpur; (viii) Darjeeling; (ix) Gaya; (x) Goalpara; (xi) Jalgaon; (xii) Kamrup; (xiii) Kancheepuram; (xiv) Nagaon; (xv) Nilgiri; (xvi) North and South Goa; (xvii) Panchmahal; (xviii) Puri; (xix) Raisen; (xx) South 24 Parganas; (xxi) Thanjavur.

(2) Conditions

In order to avail the deduction u/s. 80-ID the following conditions shall be fulfilled:

(i) The hotel is constructed and started or starts functioning at any time during 01.04.2007 and 31.07.2010.

(ii) The convention centre is constructed and started or starts functioning at any time during 01.04.2007 and 31.07.2010.

(iii) The hotel located in World heritage site should be constructed and started functioning at any time during 01.04.2008 and 31.03.2013.

(iv) The eligible business is not formed by the splitting up, or the reconstruction, of a business already in existence.

(v) The eligible business is not formed by the transfer to a new business of building previously used as a hotel or convention centre or machinery or plant previously used for any purpose.

(vi) The eligible business is not formed by transfer of machinery or plant previously used for any purpose. However, following two cases old machinery is permitted:

Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

Case 2:- Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.

(vii) Audit report in a prescribed form certifying that the deduction has been correctly claimed, shall be submitted along with the return of income.

(viii) Where an assessee avails deduction under this section, no deduction shall be allowed under any other section contained in Chapter VI-A or u/s. 10AA.

(ix) The other provisions with reference to determination of quantum of deduction, power of assessing officer to re-compute profit in case of inter-unit transfer, restriction on double deduction, transactions between close connection activities of 80 IA are equally applicable to this section.

(3) Quantum & Period of deduction

An amount equal to 100% of the profits and gains derived from such business for 5 consecutive assessment years beginning from the initial assessment year.

10.15 SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS IN NORTH-EASTERN STATES

Section:- 80-IE

(1) Eligible Business

Sec. 80-IE provides for deduction in the case of assessees who are engaged in the following business, which are commenced between 01.04.2007 and 31.03.2017 in any North - Eastern States:

a. Manufacture or production of any eligible article or thing;
b. Undertake substantial expansion to manufacture or production of any eligible article or thing;
c. Carrying on any eligible business.

For the purpose of this section

(i) "Eligible business" means the business of: (a) hotel (not below two star category); (b) adventure and leisure sports including ropeways; (c) providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds; (d) running an old-age home; (e) operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training; (f) running information technology related training centre; (g) manufacturing of information technology hardware; and (h) bio-technology.

(ii) "Substantial expansion" means increase in the investment in the plant and machinery by atleast 25% of the book value of plant and machinery (before taking depreciation in any year) as on the first day of the previous year in which substantial expansion is undertaken.

(iii) The deduction under this section is not available in respect of tobacco and manufactured tobacco substitutes, pan masala, plastic carry bags of less than 20 microns or goods produced by petroleum oil or gas refineries.

(iv) North-Eastern States for the purpose of this section are Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura

(2) Conditions

(i) The undertaking is not formed by splitting up or reconstruction of existing unit.
Exception: This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(ii) Further, undertaking should not be set up by the transfer of old plant and machinery. However, following two cases old machinery is permitted:
Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.
Case2:- Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.

(iii) Where an assessee avails deduction under section 80-IE, no deduction shall be allowed under section 10AA or sections 80C to 80U of the Act.

(iv) The other provisions with reference to furnishing of audit report, determination of quantum of deduction, power of assessing officer to re-compute profit in case of inter-unit transfer, restriction on double deduction, transactions between close connection activities of 80 IA are equally applicable to this section.

(3) Quantum and period of deduction

An amount equal to 100% of profits derived from such business for 10 years beginning with the year in which the undertaking begins to manufacture/produce article or things or complete substantial expansion initial assessment year.

UNIT D: DEDUCTIONS UNDER SECTION 80IC, 80ID, 80IE

10.16 SPECIAL PROVISIONS IN RESPECT OF SPECIFIED BUSINESS (START-UP)

Section:- 80-IAC – Effective from A.Y.2018-19

(1) Eligible Business

Business which involves innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property

(2) Conditions to be fulfilled for an eligible start-up

1. The assessee is a company or a limited liability partnership (LLP) and engaged in an eligible business.
2. The above company or LLP is incorporated after March 31, 2016 but before April 1, 2019.
3. The total turnover of the company or LLP does not exceed Rs.25 crore in any of the previous years beginning from P.Y.2016-17 and ending with P.Y.2020-21.
4. It holds a certificate of eligible business from the Inter-Ministerial Board of certification as notified in the Official Gazette by the Central Government.
5. The above company or LLP is not formed by splitting up or reconstruction of a business already in existence.

   Exception: This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;
6. Further, undertaking should not be set up by the transfer of old plant and machinery. However, following two cases old machinery is permitted:

   Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

   Case2:- *Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.*
7. The other provisions with reference to furnishing of audit report, determination of quantum of deduction, power of assessing officer to re-compute profit in case of inter-unit transfer, restriction on double deduction, transactions between close connection activities of 80 IA are equally applicable to this section.

(3) Quantum of deduction

If the above conditions are satisfied, 100 per cent of the profits and gains derived from eligible business is deductible for 3 consecutive assessment years. However, this deduction may, at the option of the assessee, be claimed by it for any 3 consecutive assessment years out of 5 years **(7 years with effect from A.Y. 2018-19, Amendment by Finance Act, 2017)** beginning from the year in which the eligible start-up is incorporated.

Practical 1

ABC Ltd. was incorporated on 1.4.2017 to carry on the business of innovation, development, deployment and commercialization of new processes driven by technology. It holds a certificate of eligible business from the notified IMBC.

Its estimated turnover and profits and gains from such business for the P.Y.2017-18 to P.Y.2023-24 are as follows:

							(Rs. in crores)
	P.Y. 2017-18	**P.Y. 2018-19**	**P.Y. 2019-20**	**P.Y. 2020-21**	**P.Y. 2021-22**	**P.Y. 2022-23**	**P.Y. 2023-24**
Total turnover	15	18	20	22	25.5	26	28
Profits/ Losses	(2.50)	(1.30)	6.80	8.40	9.80	1.60	11.20

Is ABC Ltd. eligible for any tax advantage under the p Income-tax Act, 1961? If yes, then suggest best course of action to ABC Ltd. for maximization of such benefits?

Solution

Since all the conditions of Section 80-IAC are satisfied, ABC Ltd. is entitled to claim deduction of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years out of seven years beginning from the year in which the eligible start up is incorporated i.e. P.Y.2017-18.

Consider the following options for claiming benefit under section 80-IAC

(Rs. in crores)

Sr. No.	**Options**	**Deduction for 1st Year**	**Deduction for 2nd Year**	**Deduction for 3rd Year**	**Total deductions for all the three years**
1.	Deduction claimed for P.Y. 2017-18, 2018-19 and 2019-20	Nil	Nil	3	3
2.	Deduction claimed for P.Y. 2018-19, 2019-20 and 2020-21	Nil	3	8.40	11.40
3.	Deduction claimed for P.Y. 2019-20, 2020-21 and 2021-22	3	8.40	9.80	21.20
4.	Deduction claimed for P.Y.2020-21, 2021-22 and 2022-23	8.40	9.80	1.60	19.80
5.	Deduction claimed for P.Y. 2021-22, 2022-23 and 2023-24	9.80	1.60	11.20	**22.60**
6.	Deduction claimed for P.Y. 2022-23 and 2023-24	1.60	11.20	NA	12.80
7.	Deduction claimed for P.Y. 2023-24	11.20	NA	NA	11.20

Considering the estimated turnover and profits of the ABC Ltd., it is advised to select option at Sr. No. 5 of the table above.

Readers Note:

10.17 DEDUCTIONS IN RESPECT OF PROFITS AND GAINS FROM HOUSING PROJECTS

Section:- 80-IBA – Effective from A.Y.2018-19

(1) Eligible Business

Any assessee engaged in business of developing and building a housing project.

Housing project means a project consisting predominantly of residential units with such other facilities and amenities as the competent authority may specify.

(2) Conditions

(i) The project is approved by the competent authority (*authority empowered to approve the building plan by or under any law for the time being in force)* after June 1, 2016, but on or before March 31, 2019.

(ii) The project shall be completed within a period of 3 years **(5 years with effect from A.Y. 2018-19, Amendment by Finance Act, 2017)** from the date of first approval by the competent authority. The project shall be deemed to have been completed when a certificate of completion of project as a whole is obtained in writing from the competent authority.

(iii) The built up **(carpet w.e.f A.Y. 2018-19)** area of the shops and other commercial establishments included in the housing projects does not exceed 3 per cent of the aggregate built up **(carpet w.e.f A.Y. 2018-19)** area.

(iv) Size of the plot, area of residential units and minimum utilization of FAR (floor area ratio) should satisfy the criteria given below-

Location of project	**Areas of plot of land on which project is situated**	**Areas of residential units comprised in the housing project**	**Utilization of permissible FAR**
Project is located within the cities of Chennai, Delhi, Kolkata or Mumbai ~~(or within the distance, measured aerially, of 25 kilometers from the municipal limits of these cities)~~ **Omitted by Finance Act, 2017 w.e.f. A.Y. 2018-19**	Not less than 1,000 square meters	Not to exceed 30 square meters	Not less than 90%
Project is located in any other place	Not less than 2,000 square meters	Not to exceed 60 square meters	Not less than 80

(v) The project is the only housing project on such plot of land as specified in column 2 of the above table.

(vi) Where a residential unit in the housing project is allotted to an individual, no other residential unit in the housing project shall be allotted to the individual or the spouse or the minor children of such individual.

(vii) The assessee maintains separate books of account in respect of the housing project.

(3) Quantum & Period of deduction

If the above conditions are satisfied, 100 percent of the profit derived from the aforesaid business is deductible under section 80-IBA.

However, deduction is not available to any assessee who executes the housing project as a works contract awarded by any person (including the Central/State Government). Once deduction is claimed and allowed under this section, deduction to the extent of such profit is not available under any provision of the Act.

(4) Reversal of deduction if project not completed within stipulated time

Where the housing project is not completed within 3 years **(5 years with effect from A.Y. 2018-19, Amendment by Finance Act, 2017)** from the date of first approval by the competent authority and in respect of which a deduction has been claimed and allowed under this section, the total amount of deduction so claimed and allowed in one or more previous years, shall be deemed to be income of the assessee chargeable under the head "PGBP" of the previous year in which the period for completion so expires.

UNIT E: COMMON CASE STUDIES

10.18 PRACTICAL ASPECTS OF SECTION 80 IA(5) AND A CASE STUDY

Section:- 80IA(5)

Section 80-IA(5) provides that " Notwithstanding anything contained in any other provision of this Act, for the purpose of determining the "quantum of deduction u/s80-IA for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, the profits and gains from the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the initial assessment year and to even subsequent assessment year up to and including the assessment year for which the determination is to be made.

The above section is equally applicable for determining quantum u/s 80-IB, IC, ID and IE, IAC and IBA.

Case Study 1

ABC Limited runs two different businesses namely, Business 1 which is eligible for the purpose of deduction under section 80-IC (quantum 100% for 10 years) and Business 2 which is not eligible for any special deduction under chapter VIA.

Details of income under the head "PGBP" in respect of both the businesses since their commencement are as under:

Sr. No.	Assessment Year	Business 1	Business 2
1	2007-08	(-)15	(-)2
2	2008-09	(-)12	15
3	2009-10	(-)8	14
4	2010-11	(-)4	8
5	2011-12	(-)1	5
6	2012-13	10	7
7	2013-14	20	13
8	2014-15	22	15
9	2015-16	25	3
10	2016-17	16	(-)2

Find out total income from A.Y. 2012-13 to A.Y.2016-17

Solution

	Assessment Year				
	2012-13	**2013-14**	**2014-15**	**2015-16**	**2016-17**
PGBP Income of Business 1	10	20	22	25	16
PGBP Income of Business 2	7	13	15	3	(-)2
Gross Total Income	17	33	37	28	14
Less: Deduction u/s 80-IC **[Working Note 1]**	Nil	Nil	(12)	(25)	(14) (Restricted)*
Total Income	17	33	25	3	Nil

***** Due to overriding effect of section 80 IA (5), for determining quantum of deduction u/s 80-IC, Business 1 shall be taken as the only source of income. Once quantum get determined, overriding effect comes to an end. Therefore, while claiming such deduction, same cannot exceed Gross Total Income.

Working Note 1: Computation of total income of Business 1 as if it is the only source of income.

Assessment Year	Income	Carry Forward Loss	Deduction u/s 80-IC
2007-08	(-)15	(-)15	-
2008-09	(-)12	(-)27	-
2009-10	(-)8	(-)35	-
2010-11	(-)4	(-)39	-
2011-12	(-)1	(-)40	-
2012-13	10-10= Nil	(-)30	-
2013-14	20-20= Nil	(-)10	-
2014-15	22-10= 12	-	12
2015-16	25	-	25
2016-17	16	-	16

Reader's Note:

Case Study 2

PQR Ltd. operates two business units. Unit 1 which is not eligible for any special deduction under VIA while Unit 2 is eligible for deduction under section 80 IA. For the relevant previous year, details of business income and their depreciation claim under section 32 are as under:

Particulars	Unit 1	Unit 2
PGBP Income before depreciation	32,00,000	24,00,000
Depreciation under section 32	5,00,000	26,00,000

Determine total income of PQR Ltd.

Solution

Computation of Total Income	Rs.
PGBP Income of Unit 1	27,00,000
PGBP Income of Unit 2	-2,00,000
Gross Total Income	25,00,000
Less: Deduction under section 80 IA	(Nil)
Total Income	**25,00,000**

Remark:

It is a generally accepted principle that deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in sec. 80IA(5) cannot override the sec. 70(i) of the Act. The assessee incurs loss (in eligible business) after claiming eligible depreciation. Hence sec. 80IA becomes insignificant since there is no profit from which this deduction can be claimed. Sec. 70(1) comes to the rescue of the assessee, whereby he is **entitled** to set off the **losses** from one source (eligible business) against income from another source (non-eligible business) under the same head of income. - ***CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245 (Kar.)***

Reader's Note:

10.19 CONCEPT OF "PROFIT DERIVED FROM INDUSTRIAL UNDERTAKING" VS. "PROFIT ATTRIBUTABLE TO INDUSTRIAL UNDERTAKING"

Deduction under sections 80IA to 80IE is available in respect of profit derived from eligible activity and not in respect of profit attributable to eligible activity.

Case Study 3

Discuss the eligibility of followings items while computing deduction under section 80IB.

(i) DEPB benefits and duty drawback (Popularly termed as "Export Incentives")

(ii) Interest subsidy / Transport Subsidy

(iii) Refund of excise duty

Solution

(i) DEPB benefits and duty drawback (Export Incentives)

Supreme Court, in case of Liberty India V. CIT ***317 ITR 218*** made following observation:

"We may reiterate that ss. 80-I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment. On analysis of ss. 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-s. (2), would be entitled to deduction under sub-s. (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-s. (1) purports to restrict the quantum of deduction to a specified percentage of profits. **This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".**

"**DEPB is an incentive. It is given under Duty Exemption Remission Scheme. Essentially, it is an export incentive.** No doubt, the object behind DEPB is to neutralize the incidence of customs duty payment on the import content of export product. This neutralization is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components etc. DEPB credit under the Scheme has to be calculated by taking into account the deemed import content of the export product as per basic customs duty and special additional duty payable on such deemed imports. **Therefore, in our view, DEPB/duty drawback are incentives which flow from the Schemes framed by Central Government or from s. 75 of the Customs Act, 1962, hence, incentives profits are not profits derived from the eligible business under s. 80-IB. They belong to the category of ancillary profits of such undertakings.**

Considering the above, DEPB benefits / Duty drawback are not eligible for deduction under section 80IB.

(ii) Interest Subsidy / Transport Subsidy

The issue under consideration in this case is whether transport subsidy, interest subsidy and power subsidy received from the Government can be treated as profits derived from business or undertaking to qualify for deduction under section 80-IB.

This issue came up before the **Supreme Court in CIT v. Meghalaya Steels Ltd. (2016) 383 ITR 217,** wherein it was observed that an important test to determine whether the profits and gains are derived from business or an undertaking is that there should be a direct nexus between such profits and gains and the undertaking or business. Such nexus should not be only incidental. The profits and gains referred to in section 80-IB has reference to net profit, which can be calculated by deducting from the sale price of an article, all elements of cost which go into manufacturing or selling it. Thus, the profits arrived at after deducting manufacturing costs and selling costs reimbursed to the assessee by the Government, is the profits and gains derived from the business of the assessee.

The Supreme Court observed that section 28(iiib) specifically states that income from cash assistance, by whatever name called, received or receivable by any person against exports under any scheme of the Government of India, will be income chargeable to income-tax under the head "Profits and gains of business or profession". The Apex Court further observed that if cash assistance received or receivable against exports schemes are being included as income under the head "Profits and gains of business or profession", subsidies which go to reimbursement of cost in the production of goods of a particular business would also have to be included under the head "Profits and gains of business or profession", and not under the head "Income from other sources".

Accordingly, the Supreme Court held that transport subsidy, interest subsidy and power subsidy from Government were revenue receipts which were reimbursed to the assessee for elements of cost relating to manufacture or sale of their products. Therefore, there is a direct nexus between profits and gains of the undertaking or business, and reimbursement of such subsidies. The subsidies were only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products.

Applying the rationale of the Supreme Court ruling in the above case, the interest subsidy / transport subsidy are eligible for deduction under section 80-IB.

(iii) Refund of Excise Duty

Gauhati High Court in case of CIT v. Meghalaya Steel Ltd. 332 ITR 91 made following observation:

The payment of central excise duty has a direct nexus with the manufacturing activity and similarly, the refund of the central excise duty also has a direct nexus with the manufacturing activity. The issue of payment of central excise duty would not arise in the absence of any industrial activity. There is, therefore, an inextricable link between the manufacturing activity, the payment of central excise duty and its refund.

Considering the above, refund of excise duty do qualify for deduction under section 80 IB.

Reader's Note:

10.20 CASE STUDIES ON "FIRST YEAR OF DEDUCTION UNDER THE SECTION 80 IB"

Case Study 4

Dora Dhaga Private Limited, established its industrial unit in North – Eastern States, commenced trial production in March, 2011. Its trial production (very few in terms of quantity) was sold out in March, 2011 successfully.

Discuss the validity of following contentions by parties.

1. Dora Dhaga Private Limited wants to claim deduction under section 80 IE from A.Y. 2012-13 (treating this year as first year of deduction) on the ground that commercial production started only in the financial year 2011-12.
2. Assessing Officer denied deduction of A.Y. 2012-13 on the ground that Dhora Daga failed to claim deduction in A.Y. 2011-12 (first year of operation).

Solution

1. Delhi High Court in case of **CIT v. Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. v. DCIT (2010) 322 ITR 631 (Delhi)** made following observation:

"In the present case, the assessee had sold one water cooler and one air-conditioner before April, 1998. Thus, the stage of trial production had been crossed over and the assessee had come out with the final saleable product which was in fact sold as well. The quantum of commercial sale would be immaterial. The Tribunal, in the circumstances, is right that the two types of conditions stipulated in s. 80-IA (In this case, 80IE) were fulfilled with the commercial sale of the two items in that assessment year."

Therefore, First year for deduction under section 80IE in case of Dora Dhaga Private Limited is previous year 2010-11 (A.Y. 2011-12) and not the A.Y. 2012-13.

2. Delhi High Court in case of **Praveen Soni v. CIT (2011) 333 ITR 324 (Delhi)** made following observation:

"The provisions contained in s. 80-IB of the IT Act nowhere stipulate any condition that such a claim has to be made in the first year failing which there would be forfeiture of such claim in the remaining years."

Considering the above, assessing officer is not justified in denying the claim of company for the A.Y. 2012-13.

Reader's Note:

10.21 CASE STUDIES ON "20% VALUE OF OLD PLANT AND MACHINERY"

Case Study 5

If an assessee is not entitled to deduction under section 80-IB in the year in which the industrial undertaking is started, because value of old machinery exceeds 20 per cent, he will be eligible for the deduction in the subsequent years, if the value of the old machinery in the subsequent years does not exceed 20 per cent of the total value of the machinery. In other words, deduction is not dependent upon the fact whether it was admissible in preceding assessment year— **CIT v. Seevan Plywoods [1991] 56 Taxman 296 (Ker.)**.

However, a contrary ruling given by the Karnataka High Court in **CIT v. Nippon Electronic (India) (P.) Ltd. [1990] 181 ITR 518.**

Reader's Note:

10.22 THE DEFINITION OF WORD "MANUFACTURE" UNDER INCOME TAX ACT AND CASE STUDIES ON WORD "MANUFACTURE OR PRODUCTION OF ARTICLE OR THING"

Section:- 2(29BA)

Section 2(*29BA*) defines term "manufacture", with its grammatical variations, means a change in a non-living physical object or article or thing,—

(a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure;

Case Study 6

ITO v. Arihant Tiles and Marbles P. Ltd. 320 ITR 79 (SC)

Question of law which arose before Supreme Court for determination was : Whether conversion of marble blocks by sawing into slabs and tiles and polishing amounted to 'manufacture or production of article or thing', so as to make the respondent(s)-assessee(s) entitled to the benefit of S. 80-IA of the Income-tax Act, 1961, as it stood at the material time.

According to the Supreme Court, to answer the above issue, it was necessary to note the details of stepwise activities undertaken by the assessee(s) which read as follows :

(i) Marble blocks excavated/extracted by the mine owners being in raw uneven shapes had to be properly sorted out and marked;

(ii) Such blocks were then processed on single blade/wire saw machines using advanced technology to square them by separating waste material;

(iii) Squared up blocks were sawed for making slabs by using the gang-saw machine or single/multiblock cutter machine;

(iv) The sawn slabs were further reinforced by way of filling cracks by epoxy resins and fiber netting;

(v) The slabs were polished in polishing machine; the slabs were further edge-cut into required dimensions/tiles as per market requirement in perfect angles by edge-cutting machine and multidisc cutter machines;

(vi) Polished slabs and tiles were buffed by shiner.

The Supreme Court further noted that the assessee(s) had been consistently regarded as a manufacturer/producer by various Government departments and agencies. The above processes undertaken by the respondent(s) had been treated as manufacture under the Excise Act and allied tax laws.

Before concluding, the Supreme Court thought it fit to make one observation. The Supreme Court observed that if the contention of the Department was to be accepted, namely, that the activity undertaken by the respondents herein was not a manufacture, then it would have serious revenue consequences. As stated above, each of the respondents was paying excise duty, some of the respondents were job workers and activity undertaken by them had been recognised by various Government authorities as manufacture. To say that the activity would not amount to manufacture or production u/s.80-IA would have disastrous consequences, particularly in view of the fact that the assessees in all the cases would plead that they were not liable to pay excise duty, sales tax, etc. because the activity did not constitute manufacture.

Keeping in mind the above factors, the Supreme Court was of the view that in the present cases, the activity undertaken by each of the respondents constituted manufacture or production and, therefore, they would be entitled to the benefit of S. 80-IA of the Income-tax Act, 1961.

Reader's Note:

Case Study 7

Vijay Ship Breaking Corporation & Ors. vs CIT 314 ITR 309 (SC)

The assessee firm was engaged in the business of ship breaking at Alang port during the previous year, relevant to the assessment year 1995-96. Old and condemned ships were acquired by the assessee for demolishing. The Assessing Officer in his order, inter alia, applying the ratio of decision in CIT vs N.C. Budharaja & Co. [204 ITR 412 (SC), held that ship breaking would not constitute a manufacturing or production activity and, therefore, disallowed the claim of deductions u/s. 80-I (now 80-IB) of the Act. The Supreme Court held that the legislature has used the words "manufacture" or "production". Therefore, the word "production" cannot derive its colour from the word "manufacture". Further, even in accordance with the dictionary meaning of the word "production" , the word "produce" is defined as something which is brought forth or yielded either naturally or as a result of effort and work (see Webster's New International Dictionary). It is important to note that the word "new" is not used in the definition of the word "produce".

The Supreme Court also drew support from its judgment in CIT vs Sesa Goa Ltd [2004] 271 ITR 331. The Supreme Court held that the Tribunal, in the present case, was right in allowing the deductions under section 80-I (Now 80-IB) to the assessee, holding that the ship breaking activity gave rise to the production of a distinct and different article.

Reader's Note:

Case Study 8

CIT v. Oracle Software India Ltd. 320 ITR 546 (SC)

The assessee, a 100% subsidiary of Oracle Corporation, USA, was incorporated with the object of developing designing, improving, producing, marketing, distributing, buying, selling and importing of computer software. The assessee was entitled to sub-licence the software development by Oracle Corporation, USA. The assessee imported master media of the software from Oracle Corporation, USA which it duplicated on blank discs, packed and sold in the market along with relevant brochures. The assessee made a payment a lump-sum amount to Oracle Corporation, USA for the import of master media. In addition thereto, the assessee also had to pay royalty at the rate of 30% of the price of the licensed product. The only right which the assessee had was to replicate or duplicate the software. It did not have any right to vary, amend or make value addition to the software embedded in the master media. According to the assessee, it used machinery to convert blank CDs into recorded CDs which along with other processes became a software kit. According to the assessee, the blank CD constituted raw materials. According to the assessee, the master media could not be conveyed as it is. In order to sub-licence, a copy thereof had to be made and it was the making of this copy which constituted manufacture or processing of goods in terms of S. 80-IA and consequently the assessee was entitled to deduction under that Section.

On the other hand, according to the Department, in the process of copying, there was no element of manufacture or processing of goods. According to the Department, since the software on the master media and the software on the recorded media remained unchanged, there was no manufacture or processing of goods involved in the activity of the copy or duplicating, hence, the assessee was not entitled to deduction u/s.80-IA. According to the Department, when the master media was made from what was lodged into the computer, it was a clone of the software in the computer and if one compared the contents of the master media with what was there in the computer/data bank, there was no difference, hence, according to the Department, there was no change in the use, character or name of the CDs even after the impugned process was undertaken by the assessee.

The Supreme Court observed that duplication could certainly take place at home, however, one should draw a line between duplication done at home and commercial duplication. Even a pirated copy of a CD was a duplication, but that did not mean that commercial duplication as it was undertaken in the instant case should be compared with home duplication which may result in pirated copy of a CD.

The Supreme Court held that from the details of Oracle applications, it found that the software on the master media was an application software. A commercial duplication process involved four steps.

(i) For the said process of commercial duplication, one required master media, fully operational computer, CD blaster machine (a commercial device used for replication from master media), blank/unrecorded compact disc also known as recordable media and printing software/labels.

(ii) The master media was subjected to a validation and checking process by software engineers by installing and rechecking the integrity of the master media with the help of the software installed in the fully operational computer.

(iii) After such validation and checking of the master media, the same was inserted in a machine which was called the CD Blaster and a virtual image of the software in the master media was thereafter created in its internal storage device.

(iv) This virtual image was utilised to replicate the software on the recordable media.

(v) According to the Supreme Court, if one examined the above process in the light of the details given hereinabove, commercial duplication could not be compared to home duplication. Complex technical nuances were required to be kept in mind while deciding issues of the above nature. The Supreme Court held that the term 'manufacture' implies a change, but every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the above process. If an operation/process renders a commodity or article fit for use for which it is otherwise not fit, the operation/process falls within the meaning of the word 'manufacture'. Applying the above test to the facts of the present case, the Supreme Court was of the view that, in the instant case, the assessee had undertaken an operation which rendered a blank CD fit for use which it was otherwise not fit. The blank CD was an input. By the duplicating process undertaken by the assessee, the recordable media which was unfit for any specific use got converted into the programme which was embedded in the master media and, thus, the blank CD got converted into recorded CD by the afore stated intricate process. The duplicating process changed the basic character of a blank CD, dedicating it to a specific use. Without such processing, blank CDs would be unfit for their intended purpose. Therefore, processing of blank CDs, dedicating them to a specific use, constituted a manufacture in terms of S. 80-IA(12) (b) read with S. 33B of the Income-tax Act

Reader's Note:

Case Study 9

C W E Limited is engaged in procuring parts and assembling into windmill, employed seven workers on pay-roll while five workers were hired through a contractor. C W E Limited claimed deduction under section 80 IB which was denied by Assessing Officer on following grounds :-

(i) Activity of the company does not amount to manufacture.

(ii) Company failed to employ minimum 10 workers during relevant previous year.

Examine the validity of contentions raised by Assessing Officer.

Solution

1. Madras High Court in case of **CIT v. Chiranjjeevi Wind Energy Ltd. (2011) 333 ITR 192 (Mad.)** for resolving above issue relied on Supreme Court decision in case of CIT vs. Sesa Goa Ltd. 271 ITR 331. In this decision, following observation were made:

In Words and Phrases 2nd Edition by Justice R.P. Sethi the expressions 'produce' and 'production' are described as under :

'In Webster's New International Dictionary, the word 'produce' means something that is brought forth either naturally or as a result of effort and work; a result produced. In Black's Law Dictionary, the meaning of the word 'produce' is to 'bring into view or notice; to bring to surface'.

Further, in case of Moti Laminates Vs. CCE (1995) 3 SCC 23 following observations were made:

The word 'production' or 'produce' when used in juxtaposition with the word 'manufacture' takes in bringing into existence new goods by a process, which may or may not amount to manufacture. It also takes in all the by-products, intermediate products and residual products, which emerge in the course of manufacture of goods. The expressions 'manufacture' and 'produce' are normally associated with movables, articles and goods, big and small but they are never employed to denote the construction activity of the nature involved in the construction of a dam or for that matter a bridge, a road and a building.

Applying the above test to the case on hand, the different parts procured by the respondent-assessee by themselves cannot be treated as a windmill. Those different parts bear distinctive names and when assembled together, thereafter it gets transformed into an ultimate product which is commercially known as a "windmill". There can, therefore, be no difficulty in holding that such an activity carried on by the respondent-assessee would amount to "manufacture" as well as "production" of a thing or article as set out in s. 80-IB(2)(iii) of the IT Act.

2. Bombay High Court in case of **CIT v. Jyoti Plastic Works Private Limited (2011) 339 ITR 491** made following observation:

The expression 'worker' is neither defined under s. 2 of the Act nor under s. 80-IB(2)(iv) of the Act. As per Black's Law Dictionary, the expression 'worker' means a person employed to do work for another. Under s. 2(L) of the Factories Act, 1948, the expression 'worker' means a person employed directly or by or through any agency (including a contractor) with or without the knowledge of the principal employer, whether for remuneration or not in any manufacturing process, or in any other kind of work incidental to or connected with the manufacturing process.

Therefore, in the absence of the expression 'worker' defined under the Act, it would be reasonable to hold that the expression 'worker' in s. 80-IB(2)(iv) of the Act is referable to the persons employed by the assessee directly or by or through any agency (including a contractor) in the manufacturing activity carried on by the assessee.

In the present case, though the workers employed by the assessee directly were less than ten, it is not in dispute that the total number of workers employed by the assessee directly or hired through a contractor for carrying on the manufacturing activity exceeded ten and, therefore, the Tribunal was justified in holding that the assessee complied with the condition set out in s. 80-IB(2)(iv) of the Act.

Reader's Note:

Practical 2

VKS Ltd. is engaged in developing, operating and maintaining infrastructure facility, which qualifies for deduction under section 80-lA of the Income-tax Act. The company is also engaged in producing cement. Business of the infrastructure facility was commenced in the financial year 2014-15. During the financial years 2014-15, 2015-16 and 2016-17 profits/losses of the two businesses are as follows:

		Rs. in lakhs
Financial Year	Infrastructure Facility	Cement Manufacturing
2014-15	(-) 100	120
2015-16	60	140
2016-17	75*	100

* includes freight subsidy of Rs. 10 lakhs under the scheme of the Central Government.

Further Information:

(i) Cement manufacturing unit transferred cement of certain quantity for an aggregate price of Rs. 20 lakhs. Similar quantity was sold to outside customers for Rs. 25 lakhs.

(ii) Profit of infrastructure facility business for financial year 2016-17 has been arrived at after charging purchase of consumable stores amounting to Rs. 10 lakhs from RR Ltd., a subsidiary company of VKS Ltd. as against fair market value of such items amounting to Rs. 7 lakhs.

Compute the amount admissible as deduction under section 80-IA for Assessment Year 2017-18. Give working notes and the reasons in the context of statutory provisions for giving treatment to each of the items

Solution

Readers Note:

10.23 DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM BUSINESS OF COLLECTING AND PROCESSING OF BIO-DEGRADABLE WASTE

Section:- 80JJA

(1) Eligible assessee: It means an assessee whose gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas or making pellets or briquettes for fuel or organic manure.

(2) Amount of Deduction: In computing the total income of the assessee, a deduction of an amount equal to the **whole of such profits and gains for a period of five consecutive assessment years** beginning with the assessment year relevant to the previous year in which such business commences.

(3) Other points to be kept in mind

(a) No deduction under this section shall be allowed if it has not been claimed in the return of income.

(b) Double deduction is not possible in respect of the same business income under section 80H to 80RRB.

(c) The aggregate deductions under the various provisions referred to above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be.

10.24 DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN

Section:- 80JJAA

(1) Eligible Assessee and Amount of deduction

Where the gross total income of an assessee to whom section 44AB applies, includes any profits and gains derived from business, there shall, be allowed a deduction of an amount equal to thirty per cent of additional employee cost incurred in the course of such business in the previous year, for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

(2) Conditions

(a) The business is not formed by splitting up, or the reconstruction, of an existing business: However, this condition is not applicable in respect of a business which is formed as a result of re-establishment, reconstruction or revival by the assessee of the business in the circumstances and within the period specified in section 33B;

(b) The business is not acquired by the assessee by way of transfer from any other person or as a result of any business reorganisation;

(c) The assessee furnishes alongwith the return of income the report of the accountant, as defined in the Explanation to section 288 giving such particulars in the report as may be prescribed.

(3) Other Points

(a) Explanation.—For the purposes of this section,—

(i) "additional employee cost" means total emoluments paid or payable to additional employees employed during the previous year.

- However, in the case of an existing business, the additional employee cost shall be nil, if—
  (a) there is no increase in the number of employees from the total number of employees employed as on the last day of the preceding year;
  (b) emoluments are paid otherwise than by an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account:
- For the first year of a new business, emoluments paid or payable to employees employed during that previous year shall be deemed to be the additional employee cost;

(ii) "additional employee" means an employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year.

- However, additional employee does not include,—
  (a) an employee whose total emoluments are more than twenty-five thousand rupees per month; or
  (b) an employee for whom the entire contribution is paid by the Government under the Employees' Pension Scheme notified in accordance with the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952; or
  (c) an employee employed for a period of less than 240 days during the previous year; or (150 days if assessee is engaged in the business of manufacturing of apparel)
  (d) an employee who does not participate in the recognised provident fund;

(iii) "emoluments" means any sum paid or payable to an employee in lieu of his employment by whatever name called, but does not include—

(a) any contribution paid or payable by the employer to any pension fund or provident fund or any other fund for the benefit of the employee under any law for the time being in force; and
(b) any lump-sum payment paid or payable to an employee at the time of termination of his service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and the like.

(b) No deduction under this section shall be allowed if it has not been claimed in the return of income.

(c) Double deduction is not possible in respect of the same business income under section 80H to 80RRB.

(d) The aggregate deductions under the various provisions referred to above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be.

Practical 3

Arjun Ltd. commenced the chain of medical stores on **1.4.2017**. It employed 200 employees during the P.Y.2017-18, the details of whom are as follows:

Sr. No.	No. of employees	Date of employment	Whether they participate in RPF?	Total monthly emoluments per employee (Rs.)
(i)	25	1.4.2017	Yes	20,000
(ii)	75	1.5.2017	Yes	30,000
(iii)	50	1.8.2017	No	17,000
(iv)	50	1.9.2017	Yes	22,000

Compute the deduction available to Arjun Ltd. under section 80JJAA for **A.Y.2018-19**, assuming that its total turnover is 20.21 crores and all the salary payments were made by an account payee cheques. What would have been your answer if Arjun Limited has made salary payments in cash?

Solution

Arjun Ltd. is eligible for deduction under section 80JJAA since it is subject to tax audit under section 44AB for **A.Y.2018-19**, as its total turnover from business exceeded Rs.1 crore and it has employed "additional employees" during the P.Y.**2017-18**.

Additional employee cost = Rs. 20,000 × 12 × 25 [Refer Working Note] = Rs. 60,00,000

Deduction under section 80JJAA = 30% of Rs.60,00,000 = Rs. 18,00,000.

Working Note:

Number of additional employees

Particulars	No. of employees	
Total number of employees employed during the year		200
Less: Employees who do not participate in recognized provident fund	50	
Less: Employees whose total monthly emoluments exceed Rs.25,000	75	
Less: Employees employed less than 240 days in the P.Y.**2017-18**	50	(175)
Number of "additional employees"		25

Answer will not differ even if salary payments were made in cash since the requirement of payment by account payee cheque or draft is applicable for the existing business only and not for the newly set up business.

Readers Note:

10.25 DEDUCTION IN RESPECT OF CERTAIN INCOME OF OFFSHORE BANKING UNITS AND INTERNATIONAL FINANCIAL SERVICES CENTRE

Section:- 80LA

(1) Eligible assessee :

(a) a scheduled bank and having an offshore banking unit in a special economic zone; or

(b) a foreign bank and having an offshore banking unit in a special economic zone; or

(c) a unit of International Financial Services Centre.

(2) Conditions - The following conditions should be satisfied—

(a) The gross total income of the eligible assessee includes (a) any income from the offshore banking unit in a Special Economic Zone; (b) from the business referred to in section 6(1) of the Banking Regulation Act, with an undertaking located in Special Economic Zone or any other undertaking which develops, develops and operates or operates and maintains a Special Economic Zone; (c) from any unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a centre in a Special Economic Zone.

(b) No deduction shall be allowed under this section unless assessee furnishes along with the return-

(i) The report from a Chartered Accountant in a prescribed Form certifying that the deduction has been correctly claimed in accordance with the provisions of this section should be submitted along with the return of income.

(ii) A copy of permission obtained under section 23(1)(a) of Banking Regulation Act for opening the branch of a banking company.

(3) Amount of deduction

100 per cent of the aforesaid income is allowed as deduction for 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission as stated above is obtained.

For the next 5 years, 50 per cent of such income shall be allowed as deduction

(4) Others points to be kept in mind

(a) No deduction under this section shall be allowed if it has not been claimed in the return of income

(b) Double deduction is not possible in respect of the same business income under section 80H to 80RRB.

(c) The aggregate deductions under the various provisions referred to above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be.

10.26 DEDUCTION IN RESPECT OF ROYALTY INCOME OF AUTHORS OF CERTAIN BOOKS OTHER THAN TEXT-BOOKS

Section:- 80QQB

(1) Eligible assessee: Resident Individual

(2) Conditions -

(a) Resident Individual is an author. For this purpose, author includes a joint author.

(b) His gross total income includes

- royalty or copyright fees (payable in lump sum or otherwise) in respect of any book being a work of literary, artistic or scientific nature (including advance payment which is not returnable);
- lump sum consideration for transfer (or grant) of any interest in the copyright of the book.

(c) The assessee shall have to furnish a certificate in prescribed form, duly signed by the prescribed authority along with the return of income.

(3) Amount of deduction – It shall be lower of —

(a) Rs. 3,00,000; or

(b) Royalty income as stated above.

(4) Other points to be kept in mind

(a) The "book" shall not include brochures, commentaries, diaries, guides, journals, magazines, newspapers, pamphlets, text-books for schools, tracts and other publications of similar nature, by whatever name called.

(b) Rate of royalty not to exceed 15 per cent - Where the income by way of royalty (or the copyright fee), is not a lump sum consideration in lieu of all rights of the assessee in the book, so much of the income (before allowing expenses attributable to such income) as is in excess of 15 per cent of the value of such books sold during the previous year, shall be ignored.

(c) *Royalty from outside India:* Where any income is earned from sources outside India on which the deduction under this to be claimed, then, only so much of the income shall be considered as **is brought into India** by, or on behalf of, the assesse ***in convertible foreign exchange within a period of 6 months from the end of the previous year*** or within such further period as the competent authority may allow in this behalf. Further, where any royalty is earned from sources outside India, a certificate (in the prescribed form) from the prescribed authority needs to be furnished along with the return on income.

(d) No deduction under this section shall be allowed if it has not been claimed in the return of income.

(e) Double deduction is not possible in respect of the same business income under section 80H to 80RRB.

(f) The aggregate deductions under the various provisions referred to above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be.

10.27 DEDUCTION IN RESPECT OF ROYALTY ON PATENTS

Section:- 80RRB

(1) Eligible assessee: Resident Individual

(2) Conditions

(a) Resident individual must be a patentee.

Patentee means the person (being the true and first inventor of the invention), whose name is entered on the patent register as the patentee, in accordance with the Patents Act, 1970. It includes every such person (being the true and first inventor of the invention) where more than one person is registered as patentee under that Act in respect of that patent.

(b) He is in receipt of any income by way of royalty in respect of patent, which is registered under the Patent Act after March 31,2003.

(c) The assessee shall have to furnish a certificate in prescribed form, duly signed by the prescribed authority along with the return of income.

(3) Amount of deduction – It shall be lower of —

(a) Rs. 3,00,000; or

(b) Royalty income.

(4) Other points to be kept in mind

(a) *Royalty does not include* any consideration, which is chargeable under the head "Capital gains".

(b) *Royalty from outside India:* Where any income is earned from sources outside India on which the deduction under this to be claimed, then, only so much of the income shall be considered as **is brought into India** by, or on behalf of, the assesse ***in convertible foreign exchange within a period of 6 months from the end of the previous year*** or within such further period as the competent authority may allow in this behalf. Further, where any royalty is earned from sources outside India, a certificate (in the prescribed form) from the prescribed authority needs to be furnished along with the return on income.

(c) *Limit when compulsory licence granted* : Where a compulsory licence is granted in respect of any patent under the Patents Act, 1970, the income eligible for the purposes of this section shall not exceed the amount of royalty under the terms and conditions of a licence settled by the Controller under that Act.

(d) No deduction under this section shall be allowed if it has not been claimed in the return of income.

(e) Double deduction is not possible in respect of the same business income under section 80H to 80RRB.

(f) The aggregate deductions under the various provisions referred to above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be.

UNIT F: REMAINING DEDUCTION UNDER SECTION 80C TO 80U

10.28 BASIC RULES

Section:- 80A

(a) The aggregate amount of deduction u/s 80C to 80U shall not exceed gross total income of assessee.

(b) No deductions under section 80C to 80U can't be claimed from long-term capital gains, short-term capital gains under section 111 A, winnings from lottery, races, etc.

(c) Where an association of persons or body of individuals is entitled for deductions under section 80G, 80GGA, 80GGC, 80-IA, 80-IB, 80-IC, 80-ID, 80IE and 80 TTA, a member thereof cannot claim the same deduction in his individual assessment in relation to his share in the total income of the association of persons or body of individuals.

10.29 DEDUCTION IN RESPECT OF LIFE INSURANCE PREMIA, DEFERRED ANNUITY, CONTRIBUTIONS TO PROVIDENT FUND, SUBSCRIPTION TO CERTAIN EQUITY SHARES OR DEBENTURES, ETC.

Section:- 80C

Section 80C provides deduction in respect of specified qualifying amounts paid or deposited by the assessee in the previous year.

(1) Eligible assessee:- Individual or a Hindu undivided family.

(2) Payments / deposits / contributions eligible for deduction under section 80 C

(a) Life insurance premium

Note

In the case of an individual life insurance policy may be taken on his own life, life of the spouse or any child.

In the case of a Hindu undivided family, policy may be taken on the life of any member of the family.

Deduction in respect of Insurance Premium paid cannot exceed the ceiling given below-

	Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified under section 80DDB.	*Where the insurance is on the life of any other person*
In respect of policies issued between 1.4.2003 and 31.3.2012	*20% of sum assured*	*20% of sum assured*
In respect of policies issued on or after 1.4.2012 but before 1.4.2013	*10% of sum assured*	*10% of sum assured*
In respect of policies issued on or after 1.4.2013	*15% of sum assured*	*10% of sum assured*

Sum assured means minimum amount assured under the policy. Further, sum assured will not include any premium agreed to be returned and /or any benefit by way of bonus or otherwise.

(b) Premium paid in respect of a contract for deferred annuity

Note: Annuity plan may be taken in the name of the individual, his wife/her husband or any child of such individual.

(c) Any sum deducted from salary payable to a Government employee for the purpose of securing a deferred annuity (subject to a maximum of one-fifth of salary)

Note: This annuity shall be for the benefit of the individual, his wife or children.

(d) Contribution towards statutory provident fund

(e) Contribution (not being repayment of loan) towards 15 year public provident fund

Note:

In the case of an individual, the provident fund account may be in his own name or in the name of his/ her spouse or any child.

In the case of a Hindu undivided family, provident fund account may be in the name of any member of the family.

(f) Contribution by an exmploee towards recognized provident fund

(g) Contribution by an employee towards an approved superannuation fund

(h) Subscription to National Savings Certificates, VIII Issue including accrued interest thereon or IX Issue.

(i) Deposit in **'Sukanya Samriddhi Account' [Notification No. 9/2015 [F.NO.178/3/2015-ITA-I]/SO 210(E), Dated 21-1-2015]**

Note: In the case of an individual, deposit in Sukanya Samriddhi Account can be made in the name of individual, or any girl child of that individual or any girl child for whom such person is the legal guardian, if the scheme so specifies.

(j) Contribution in the unit-linked insurance plan (ULIP) of Unit Trust of India

Note : In the case of an individual, ULIP may be taken on his own life, life of the spouse or any child. In the case of a Hindu undivided family, ULIP may be taken on the life of any member of the family.

(k) Contribution in the unit-linked insurance plan (ULIP) of LIC Mutual Fund

Note : In the case of an individual, ULIP may be taken on his own life, life of the spouse or any child. In the case of a Hindu undivided family, ULIP may be taken on the life of any member of the family

(l) Payment for notified annuity plan of LIC (i.e., New Jeevan Dhara, Jeevan Akshay) or any other insurer (Tata AIG Easy Retire Annuity Plan

(m) Subscription towards notified units of Mutual Fund or UTI

(n) Contribution to notified pension fund set up by Mutual Fund or UTI

(o) Subscription to any notified deposit scheme or pension fund set up by the National Housing Bank. [National Housing Bank (Tax Saving) Term Deposit Scheme, 2008 vide Notification No. 3/2009]

(p) Subscription to any deposit scheme of—

- **a.** public sector company engaged in providing long-term finance for purchase/construction of residential houses in India;
- **b.** housing board constituted in India for the purpose of planning, development or improvement of cities, towns and villages or both.

(q) Any sum paid as tuition fees (excluding any payment towards development fees / donation / payment of similar nature) whether at the time of admission or otherwise to any university or college or educational institution in India for full time education of any two children of the individual [Note 10]

Note : Full-time education includes any educational course offered by any university, college, school or other educational institution to a student who is enrolled full-time for the said course. Full-time education includes play-school activities, pre - nursery and nursery classes. –Circular No. 17/2014, dated December 10, 2014.

(r) The following payment made towards the cost of purchase/construction of a new residential house property is qualified for the purpose of section 80C :

a. **any instalment or part payment of the amount due under any self-financing or other scheme of any development authority, housing board** or other authority engaged in the construction and sale of house property on ownership basis ; or

b. **any instalment or part payment of the amount due to any company or co-operative society of which the assessee is a shareholder or member:): towards the cost of the house property allotted to him** (it is not applicable if the assessee is not a shareholder or member of the company/co-operative society which provides house to the assessee); or

c. **repayment of the amount borrowed by the assessee from** —

- **(i)** the Central Government or any State Government, or
- **(ii)** any bank, including a co-operative bank, or
- **(iii)** the Life Insurance Corporation of India, or
- **(iv)** the National Housing Bank, or
- **(v)** any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes which is eligible for deduction under section 36(1)(viii),or

(vi) any company in which the public are substantially interested or any co-operative society, where such company or co-operative society is engaged in the business of financing the construction of houses, or

(vii) the assessee's employer where such employer is an authority or a board or a corporation or any other body established or constituted under a Central or State Act, or

(viii) the assessee's employer where such employer is a public company or public sector company, or a university established by law or a college affiliated to such university or local authority or co-operative society;

d. **stamp duty, registration fee and other expenses for the purpose of transfer of such house property to the assessee.**

Note:

The following payments are not qualified for the purpose of section 80C :

a. the admission fee, cost of the share and initial deposit which a shareholder of a company or a member of a co-operative society has to pay for becoming such shareholder or member; or

b. the cost of any addition or alteration to, or renovation or repair of, the house property which is carried out after the issue of the completion certificate in respect of the house property by the authority competent to issue such certificate or after the house property (or any part thereof) has either been occupied by the assessee or any other person on his behalf or been let out; or

c. any expenditure in respect of which deduction is allowable under the provisions of section 24.

(s) Subscription to equity shares or debentures of a public company engaged in infrastructure including power sector or units of a mutual fund proceeds of which are utilised for the purpose of business referred to in section 80 IA (4)

(t) Subscription to any units of any mutual fund referred to in section 10(23D) and approved by the Board.

Note:

It is necessary that such units shall be subscribed only in the issue made by the public company formed in India or a public financial institution and entire proceeds of the issue are utilized wholly and exclusively for the purpose of business referred to in section 80 IA (4)

(u) ***Amount deposited as term deposit for a period of not less than 5 years and it is in accordance with a scheme framed and notified by the Central Government.***

(v) ***Subscription to any notified bonds of National Bank for Agriculture and Rural Development (NABARD)***

(w) ***Amount deposited under Senior Citizens Saving Scheme***

(x) ***Amount deposited in fiver year time deposit scheme in post office.***

(3) Amount of Deduction – The amount deduction under section 80C shall not exceed Rs. 1,50,000.

(4) Lock-in-period

In respect of the few investments/deposits/contributions eligible for deduction under section 80C, law provides lock-in-period.

Investments/deposits/contribution	Lock-in-period
Unit-linked insurance plan (ULIP)	5 years
Life insurance premium	2 years
House Property	5 years
Deposit under Senior Citizen Saving Scheme	5 years
Time Deposit in Post Office	5 years

(5) Consequences when lock-in-period not observed.

(a) ULIP: Where a member participating in ULIP, terminates his participation before 5 years, then following consequences would arise

Any contribution made towards ULIP in the year of termination shall not be eligible for deduction under section 80C.
The amount of deduction already claimed under this section in the earlier years shall be deemed as income of the taxpayer in the year in which ULIP is terminated.

(b) A similar rule is to be followed in case of termination of life insurance policy before 2 years and transfer of residential house property before 5 years.

(c) In case of withdrawal before 5 years by the depositor during his lifetime from amount deposited under Senior Citizen Saving Scheme or time deposit in Post Office, the amount withdrawn shall be taxable in the year of withdrawal. For this purpose, interest which has already been taxed in earlier years shall be excluded.

10.30 DEDUCTION IN RESPECT OF PENSION FUND

Section:- 80CCC

(1) Eligible assessee: - Individual

(2) Conditions

(a) The amount shall be paid paid/deposited under an annuity plan of the Life Insurance Corporation of India or any other insurer for receiving pension.

(b) The aforesaid amount is paid out of income chargeable to tax.

(3) Amount of deduction– The amount deduction under section 80CCC shall not exceed Rs. 1,50,000.

(4) Other points to be kept in mind

(a) Where the assessee or his nominee surrenders the annuity before maturity, the surrender value shall be taxable in the hands of the assessee or his nominee, as the case may be, in the year of the receipt.

(b) The amount received by the assessee or his nominee as pension shall be taxable, in the hands of the assessee or the nominee, as the case may be.

(c) If deduction is claimed under section 80C, in respect of the same investment, deduction is not available under section 80CCC.

10.31 DEDUCTION IN RESPECT OF CONTRIBUTION TO PENSION SCHEME OF CENTRAL GOVERNMENT OR ANY OTHER EMPLOYER

Section:- 80CCD

(1) Eligible assessee - Individual who is employed by the Central Government (on or after January 1, 2004) or being an individual employed by any other employer or any other assessee being an individual (self-employed person)

(2) Conditions - The amount shall be paid or deposited in any account under a pension scheme notified by the Central Government.

(3) Amount of deduction

(a) Employee's contribution is deductible as does not exceed 10 per cent of the salary of the employee. *In case of self-employed person, contribution to pension scheme is deductible as does not exceed 20 percent of his gross total income*. ***[Section 80CCD(1)]***

(b) ***With effect from A.Y. 2016-17 sub section (1B) has been inserted in section 80CCD so as to provide for an additional deduction in respect of any amount paid (upto Rs.50,000) for contributions made by any individual assessee under the NPS. On this additional contribution, the ceiling of Rs.1,50,000 under section 80CCE will not be applicable.***

(c) Contribution by the Central Government or employer to the notified pension scheme is deductible as does not exceed 10 per cent of the salary of the employee. ***[Section 80CCD(2)]***

(4) Other points to be kept in mind

(a) The amounts standing to the credit of the employee in the pension account, for which a deduction has already been claimed by him, and the amount accrued on them, shall be taxed as income in the year in which such amounts are received by the assessee (or his nominee) on closure of the account or his opting out of the said scheme or on receipt of pension from the annuity plan. **[Section 80CCD(3)]**

With effect from A.Y.2017-18, the amount received by the nominee, on the death of the assessee, on closure or opting out of NPS, shall not be deemed to be the income of the nominee. **[Proviso to 80CCD (3)]**

(b) If deduction is claimed under section 80C, in respect of the same investment, deduction is not available under section 80CCD.

(c) "Salary" for the purpose of points 1 and 2 (supra) includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites. ***[Amendment made by Finance Act, 2014, w.e.f from A.Y 2015-16]***

10.32 LIMIT ON DEDUCTIONS UNDER SECTION 80 C, 80 CCC AND 80 CCD

Section:- 80CCE

The aggregate amount of deduction under sections 80C, 80CCC and 80CCD(1) cannot exceed Rs. 1,50,000.

Readers are requested to consider the following summary:-

SECTION	***MAXIMUM DEDUCTION***	
	For A.Y. 2017-18	***From A.Y. 2018-19***
80C	*Rs.1,50,000*	*Rs.1,50,000*
80CCC	*Rs.1,50,000*	*Rs.1,50,000*
*80CCD(1) [i.e., employee's or **assessee's contribution to NPS**]*	*[10% of Salary or 10% of GTI as the case may be]*	*10% of Salary or **20% of GTI** as the case may be.*
80CCE : The aggregate deduction under sections 80C, 80CCC and 80CCD(1)	*Rs.1,50,000*	*Rs.1,50,000*
80CCD(1B) [i.e., contribution to NPS by an individual]	*Rs.50,000*	*Rs.50,000*
80CCD(2) [i.e., employer's contribution to NPS]	*10% of salary*	*10% of salary*

10.33 DEDUCTION IN RESPECT OF MEDICAL INSURANCE PREMIA

Section:- 80D

(1) Eligible assessee: - Individual or Hindu undivided family

(2) Conditions –

(a) Mediclaim insurance is paid by the individual or HUF. In the case of individual, payment can also be made to the Central Government Health Scheme or such other scheme as may be notified by the Central Government in this behalf and/or on account of preventive health check-up.

(b) It is paid out of income chargeable to tax.

(c) Payment shall be made by any mode other than cash. However, payment on account of preventive health check-up can be made by any mode including cash.

(3) Maximum Deductible Amount:- The maximum deductible amount and other relevant points are given below-

	Individual		**HUF**
	Family	**Parents**	
• **For whose benefits payment can be made**	For the benefit of the assessee, spouse of the assessee and dependent children of the assesse	For the benefit of the parents of the assessee whether dependent or not	For the benefit of any member of family

(A) Nature of payment			
a. Medi-claim insurance premium	Deduction available	Deduction available	Deduction available
b. Contribution made to Central Government Health Scheme or such other scheme as may be notified by the Central Government in this behalf	Deduction available	-	-
c. Payment made on account of preventive health check-up (from the assessment year 2013-14 onwards)	Deduction available	Deduction available	-
Maximum amount of deduction			
- General deduction [applicable in respect of (a), (b) and (c) given above but payment on account of preventive health check-up of self, spouse, dependent children and parents cannot exceed Rs.5,000]	***Rs.25,000***	***Rs.25,000***	***Rs.25,000***
- Additional deduction (applicable only in the case of medi-claim insurance premium when policy is taken on the life of a senior citizen)	Rs.5,000	Rs.5,000	Rs.5,000
(B) *Medical Expenditure on the health of a person who is a* ***super senior citizen*** *if med-claim insurance is not paid on the health of such person*	*Deduction available*	*Deduction available*	*Deduction available*
- *Maximum deduction in respect of (B)*	***Rs.30,000***	***Rs.30,000***	***Rs.30,000***
(C) *Maximum deduction in respect of (A) and (B)*	***Rs.30,000***	***Rs.30,000***	***Rs.30,000***

NOTE:

(1) Senior citizen for the aforesaid purpose is a resident individual and whose age at any time during the relevant previous years should be at least ***60 years.***

(2) *Super Senior citizen for the aforesaid purpose is a resident individual and whose age at any time during the relevant previous years should be at least* ***80 years.***

10.34 DEDUCTION IN RESPECT OF INVESTMENT MADE UNDER ANY EQUITY SAVING SCHEME

Section:- 80CCG

Deduction under section 80CCG will not be allowed from A.Y. 2018-19. However, an assessee who has claimed benefit under this section for A.Y. 2017-18 and earlier assessment years shall be allowed to claim deduction under this section upto A.Y. 2019-20.

10.35 DEDUCTION IN RESPECT OF MAINTENANCE INCLUDING MEDICAL TREATMENT OF A DEPENDENT BEING A PERSON WITH DISABILITY

Section:- 80DD

(1) Eligible assessee: - Resident Individual or Resident Hindu undivided family

(2) Conditions –

(a) The eligible assessee —

Option 1	Option 2
has incurred an **expenditure for the medical treatment** (including nursing), training and rehabilitation of a dependent, being a person with disability	has **paid or deposited under any scheme framed** in this behalf by the Life Insurance Corporation or any other insurer, or the administrator or specified company and approved by the Board in this behalf, for maintenance of dependent, being a person with disability

For the above purpose, a "dependent being a person with disability" is a person who satisfies the followings—

a. in the case of an individual, dependent means the spouse, children, parents, brothers and sisters of the individual or any of them;
b. in the case of a Hindu undivided family, "dependent" means a member of a Hindu undivided family;
c. such person is wholly or mainly dependent upon such individual or Hindu undivided family for support and maintenance;
d. such person has not claimed any deduction under section 80U in computing his total income for the assessment year relating to the previous year;

(b) The assessee shall have to furnish a copy of the certificate in a prescribe form issued by the medical authority along with the return of income.

(3) Amount of deduction

The amount deductible is a <u>fixed</u> deduction of Rs.75,000 irrespective of the amount incurred or deposited under Option 1 and/or Option 2.

A higher deduction of Rs. 1,25,000 shall be allowed, where such dependent is a person **with severe disability**.

(4) Other points to be kept in mind

(a) Person with disability means the individuals who suffers 40 per cent or more than 40 per cent of any disability given below—

- blindness;
- low vision;
- leprosy-cured;
- hearing impairment;
- locomotor disability;
- mental retardation;
- mental illness.

(b) Person with sever disability means the individuals who suffers 80 percent or more of one or more disabilities mentioned above.

(c) If dependent predeceases the taxpayer- If the dependent with disability predeceases the individual or the member of the Hindu undivided family referred to above***, an amount equal to the amount paid or deposited as stated above 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.

10.36 DEDUCTION IN RESPECT OF MEDICAL TREATMENT, ETC.

Section:- 80DDB

(1) Eligible assessee: - Resident Individual or Resident Hindu undivided family

(2) Conditions –

1. The assessee **has actually paid any amount for the medical treatment of a specified disease** or ailment as prescribed by the Board under rule 11DD.
2. If the assessee is an Individual, the expenditure is actually incurred for his medical treatment or wholly/ mainly dependent spouse, children, parents, brothers and sisters of such individual.
3. If assessee is a Hindu undivided family, the expenditure is actually incurred for the medical treatment of any member of the family who is wholly/mainly dependent upon the family.
4. **From A.Y. 2016-17, the assessee is required to obtain a prescription form a specialist doctor for the purpose of availing this deduction.**

(3) Amount of deduction - If all the aforesaid conditions are satisfied, **the amount of deduction is Rs. 40,000 or the expenditure actually incurred, whichever is lower.**

(a) Where the expenditure incurred is in respect of the assessee or his dependent or any member of a Hindu undivided family of the assessee and who is a **senior citizen**, **then Rs. 60,000 or actual expenditure, whichever is lower,** shall be the amount of deduction.

(b) Where the expenditure incurred is in respect of the assessee or his dependent or any member of a Hindu undivided family of the assessee and who is a **super senior citizen**, **then Rs. 80,000 or actual expenditure, whichever is lower,** shall be the amount of deduction.

(c) 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 above.

Summary:

Sr. No.	Dependent	Maximum Deduction (Rs.)
(1)	A very senior citizen, being a resident individual	80,000
(2)	A senior citizen, being a resident individual	60,000
(3)	Dependent, other than mentioned in (1) and (2) above	40,000

10.37 DEDUCTION IN RESPECT OF REPAYMENT OF LOAN TAKEN FOR HIGHER STUDIES

Section:- 80E

(1) Eligible assessee: Individual

(2) Conditions:

(a) He had taken a loan from any bank, financial institution or an approved charitable institution for the purpose of pursuing ***any course of studies pursued after passing the senior secondary examinations or its equivalent from any recognized board.***

(b) The loan was taken by the taxpayer for the purpose of pursuing **his own higher education or of his relatives. For this purpose, relative means** ***spouse and children of that individual or student for whom the individual is the legal guardian.***

(c) Amount is paid by the individual during the previous year by **way of interest on such loan out of his income chargeable to tax.**

(3) Amount deductible -The entire amount paid by way of interest is deductible under this section

(4) Period of Deduction: The **above** deduction is allowed in computing the taxable income of the initial assessment year (i.e., the assessment year relevant to the previous year in which the assessee starts paying the interest on the loan) and 7 immediately succeeding assessment years or until the above interest is paid in full, whichever is earlier.

10.38 DEDUCTION IN RESPECT OF INTEREST ON LOAN TAKEN FOR RESIDENTIAL HOUSE PROPERTY

Section:- 80EE – Effective from A.Y.2017-18

(1) Eligible Assessee:- Individual

(2) Conditions

(a) He has taken loan from any financial institution for the purpose of acquisition of a residential house property.

(b) the loan has been sanctioned by the financial institution during the period beginning on the 1st day of April, 2016 and ending on the 31st day of March, 2017;

(c) the amount of loan sanctioned for acquisition of the residential house property does not exceed thirty-five lakh rupees;

(d) the value of residential house property does not exceed fifty lakh rupees;

(e) the assessee does not own any residential house property on the date of sanction of loan.

(3) Amount deductible:- The maximum deduction allowable is Rs. 50,000. This deduction is over and above the deduction available u/s 24 of the Act.

(4) Other points to be kept in mind

(a) Financial institution

(i) A banking company to which the Banking Regulation Act, 1949 applies ; or

(ii) Any bank or banking institution referred to in section 51 of the Banking Regulation Act, 1949; or

(iii) A housing finance company.

(b) Housing finance company

A public company formed or registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

Practical 4

Mr. Rajababu entered into an agreement to purchase a residential house property for self-occupation at a cost of Rs. 40 lakh on 01.02.2016. For this purpose, he took a housing loan of Rs. 32 lakh from State Bank of India @10% p.a. The Loan was sanctioned on 10.4.2016 and was disbursed on 31.05.2016. Compute the eligible deduction in respect of interest on housing loan for A.Y.2017-18 under the provisions of the Income-tax Act, 1961, assuming that the entire loan was outstanding as on 31.3.2017 and he does not own any other house property.

Does your answer differ if loan was sanctioned on 01.02.2016?

Solution

Computation of Interest Deduction for A.Y. 2017-18

Particulars	Rs.
Interest Deduction	
(1) Under the head "House Property" (section 24)	
Interest on Loan $\left(32{,}00{,}000 \times 10\% \times \frac{10}{12}\right)$=Rs.2,66,667	
Deduction = Rs.2,66,667 or Rs.2,00,000 whichever is lower	2,00,000
(2) From Gross Total Income u/s 80EE	
Balance Interest on loan = Rs.2,66,667 – Rs,2,00,000 = Rs.66,667	
Deduction = Rs.66,667 or Rs.50,000 whichever is lower	50,000
Total Benefit of deduction to Mr. Rajababu	**2,50,000**

Readers Note:

10.39 DEDUCTION IN RESPECT OF DONATION TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC.

Section:- 80G

(1) Eligible Assessee:- Any person

(2) Mode of payment: Donation can be given in cash or by cheque or draft. However, no deduction shall be allowed u/s 80G in respect of donation in cash of an amount exceeding Rs.2,000.

(3) Amount deductible:-

There are four categories of deductions. The following table gives the details of the institutions and funds to which donations can be made for the purpose of claiming deduction under section 80G, –

(A) Donation qualifying for 100% deduction, without any upper limit

Sr. No.	Donee
(1)	The National Defence Fund set up by the Central Government
(2)	Prime Minister's National Relief Fund.
(3)	Prime Minister's Armenia Earthquake Relief Fund
(4)	The Africa (Public Contributions-India) Fund
(5)	The National Children's Fund
(6)	The National Foundation for Communal Harmony
(7)	Approved University or educational institution of national eminence
(8)	Maharashtra Chief Minister's Earthquake Relief Fund
(9)	Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of the Gujarat earthquake
(10)	Any Zila Saksharta Samiti for primary education in villages and towns and for literacy and post-literacy activities
(11)	National Blood Transfusion Council or any State Blood Transfusion Council whose sole objective is the control, supervision, regulation or encouragement of operation and requirements of blood banks
(12)	Any State Government Fund set up to provide medical relief to the poor
(13)	The Army Central Welfare Fund or Indian Naval Benevolent Fund or Air Force Central Welfare Fund established by the armed forces of the Union for the welfare of past and present members of such forces or their dependents
(14)	The Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996
(15)	The National Illness Assistance Fund
(16)	The Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund
(17)	The National Sports Fund set up by the Central Government

(18)	The National Cultural Fund set up by the Central Government
(19)	The Fund for Technology Development and Application set up by the Central Government
(20)	National Trust for welfare of persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities
(21)	The Swachh Bharat Kosh, set up by the Central Government, other than the sum spent by the assessee in pursuance of CSR u/s 135(5) of the Companies Act, 2013
(22)	The Clean Ganga Fund, set up by the Central Government, where such assessee is a resident, other than the sum spent in pursuance of CSR u/s 135(5) of the Companies Act, 2013
(23)	The National Fund for Control of Drug Abuse constituted under section 7A of the Narcotic Drugs and Psychotroic Substances Act, 1985

(B) Donation qualifying for 50% deduction, without any upper limit

Sr. No.	Donee
(1)	Jawaharlal Nehru Memorial Fund
(2)	Prime Minister's Drought Relief Fund
(3)	Indira Gandhi Memorial Trust
(4)	Rajiv Gandhi Foundation

(C) Donation qualifying for 100% deduction, subject to upper limit

Sr. No.	Donee
(1)	The Government or to any approved local authority, institution or association for promotion of family planning
(2)	Sum paid by a company as donation to the Indian Olympic Association or any other association/institution established in India, as may be notified by the Government for the development of infrastructure for sports or games, or the sponsorship of sports and games in India

(D) Donation qualifying for 50% deduction, subject to qualifying limit

Sr. No.	Donee
(1)	Any Institution or Fund established in India for charitable purposes fulfilling prescribed conditions
(2)	The Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning
(3)	An authority constituted in India by or under any other law enacted either for dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or both
(4)	Any Corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community
(5)	for renovation or repair of Notified temple, mosque, gurdwara, church or other place of historic, archaeological or artistic importance or which is a place of public worship of renown throughout any State or States

NOTE

1. Donations to Swachh Bharat Kosh and Clean Ganga Fund will be eligible for deduction under section 80G only if the amount is not spent by the assessee in pursuance of Corporate Social Responsibility under section 135(5) of the Companies Act, 2013.
2. The eligible donations referred to in (C) and (D) should be aggregated and the sum total should be limited to 10% of the adjusted gross total income.

"Adjusted gross total income" shall be calculated as follows—

Find out gross total income	xxxx
Less: Long-term capital gains	xxxx
Less: Short-term capital gains taxable under section 111A	xxxx
Less: Income referred to in section 115A	xxxx
Less: Amount deductible under sections 80C to 8OU (except section 80G)	xxxx
"Adjusted gross total income" for the purpose of section 80G	**xxxx**

(4) Other Points to be kept in mind

(a) Donation made in kind shall not be deductible.
(b) Donation directly to beneficiary is not deductible
(c) Donation to any trust established for benefit of particular community or caste is not deductible.

Practical 5

The assessee trust filed an application in Form 10G for grant of approval under section 80G(5). It also filed copies of trust deed and registration certificate dated 18th August, 2011 with the approving authority. As per the trust deed, the main objects of the trust are educational, social activities, etc. In order to verify the facts stated in the application, the trust was asked to produce books of account, relevant vouchers, donation book and minutes in original. On perusal of the books for financial year 2011-12, it was found that the trust had not applied 85% of its income and therefore, the Commissioner rejected the application of the assessee seeking approval under section 80G(5) and Rule 11AA of the Income-tax Rules, 1962.

Can the Commissioner reject an application for grant of approval under section 80G(5) on the ground that the trust has failed to apply 85% of its income for charitable purposes?

Solution

Gujarat High Court in case of **CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619** was of the view that the issue in the present case has already been settled in case of N.N. Desai Charitable Trust v. CIT (2000) 246 ITR 452 (Guj). In that case, the Division Bench observed that, while considering the application for the purpose of section 80G, the authority cannot act as an assessing authority and the enquiry should be confined to finding out if the institution satisfies the prescribed conditions. The Division Bench also made the following observations:

(i) Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions

(ii) There are two distinct concepts. The first is whether an institution or fund is such whose income is not liable to be included in the computation of total income, has to be determined on the basis of its status or character. The second is the actual assessment of income, which necessarily takes place in future after donation is received by the donee, on fulfilment of other conditions about application of income by the eligible trusts, which in the very nature of things can operate only after receipt of income. The two are different concepts.

(iii) The liability to assessment is neither affected on account of grant of recognition under section 80G nor on whether the donor ultimately gets deduction in respect of such donation. Once a trust is registered under section 12AA, its income from property includes donation which is covered by section 11(1)(d) or under section 12. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.

(iv) The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income because non-fulfillment of some conditions by the donee-trust as regards application or accumulation cannot be ascertained in praesenti, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

(v) The High Court also noted that similar views were expressed by the Punjab and Haryana High Court in the case of CIT v. O. P. Jindal Global University (2013) 38 Taxmann.com 366.

Considering the above, the Commissioner cannot reject an application for grant of approval under section 80G(5) on the ground that the trust has failed to apply 85% of its income for charitable purposes.

Readers Note:

10.40 DEDUCTION IN RESPECT OF RENT PAID

Section:- 80GG

(1) Eligible assessee: Individual who is not in receipt of house rent allowance at any time during the previous year.

(2) Conditions:

(a) The assessee incurs expenditure towards payment of rent in respect of any furnished or unfurnished accommodation occupied by him for the purposes of his own residence.

(b) The assessee is required to file a declaration in a prescribed form regarding expenditure incurred by him towards payment of rent.

(3) Amount of deduction - If the above five conditions are satisfied, the amount deductible under section 80GG is the least of the following three—

(a) Rs. 5,000 per month;

(b) 25 per cent of total income; or

(c) the excess of actual rent paid over 10 per cent of total income.

Meaning of total income for the purpose of this section

Total income shall be calculated as follows—

Find out gross total income	xxxx
Less: Long-term capital gains	xxxx
Less: Short-term capital gains taxable under section 111A	xxxx
Less: Income referred to in section 115A	xxxx
Less: Amount deductible under sections 80C to 8OU (except section 80GG)	xxxx
Total income for the purpose of section 80GG	**xxxx**

(4) Other points to be kept in mind

The deduction under this section shall not be available if following persons own any residential accommodation at the place where the taxpayer resides, performs the duties of his office, or employment or carries on his business or profession—

(a) the assessee;

(b) his spouse;

(c) his minor child;

(d) the Hindu undivided family of which the assessee is a member.

Practical 6

Mr. Shiva, a businessman, whose total income (before allowing deduction under section 80GG) for A.Y.2017-18 is Rs. 5,00,000, paid house rent at Rs. 10,000 p.m. in respect of residential accommodation occupied by him at Mumbai. Compute the deduction allowable to him under section 80GG for A.Y.2017-18.

Solution

The deduction is allowable up to the least of the three limits –

(1) 25% of total income

= 5,00,000 × 25%

= Rs.1,25,000

(2) Rent paid - 10% of total income

= Rs.1,20,000 – (Rs.5,00,000 x 10%)

= Rs.1,20,000 – Rs.50,000

= Rs.70,000

(3) Rs. 5,000 per month

=Rs.5,000 x 12

=Rs.60,000

Admissible deduction u/s 80GG is Rs.60,000

Readers Note:

10.41 DEDUCTION IN RESPECT OF CERTAIN DONATIONS FOR SCIENTIFIC RESEARCH OR RURAL DEVELOPMENT

Section:- 80GGA

(1) Eligible assessee: Every 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 deduction in the computation of his total income in respect of the followings:

- Sum paid to a research association which has as its object the undertaking of scientific research, or to a university, college or other institution to be used for scientific research where such association, university, college or institution has been approved by the prescribed authority for the purpose of section 35(1)(ii).
- Sum paid to a research association, university, college or other institution to be used for research in social science or statistical research provided such university, college or institution is approved for the purposes of section 35(1)(iii).
- Sum 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).
- Sum paid to an approved association or institution which has as its object the training of persons for implementing programmes of rural development provided the assessee furnishes a certificate referred to in section 35CCA(2A).
- Sum paid to a public sector company, local authority or an approved association or institution for carrying out any eligible project or scheme, referred to in section 35AC provided the assessee furnishes a certificate referred to in section 35AC(2)(a).
- Sum paid to the National Fund for Rural Development set up and notified by the Central Government for the purpose of carrying out rural development.
- Sums paid to the notified National Urban Poverty Eradication Fund.

(2) Condition: No deduction shall be allowed under section 80GGA in respect of donation in cash of an amount exceeding Rs.10,000.

(3) Other points to be kept in mind - 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.

10.42 DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY COMPANIES TO POLITICAL PARTIES

Section:- 8GGB

In computing the total income of an Indian company, any sum contributed by it to any political party or electoral trust is deductible.

From the A.Y. 2014-15, no deduction shall be allowed in respect of any sum contributed by way of cash.

10.43 DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY ANY PERSON TO POLITICAL PARTIES

Section:- 80GGC

In computing the total income of an assessee (not being local authority and every artificial juridical person wholly or partly funded by the Government), any amount of contribution made by him to a political party or *electoral trust* is deductible.

From the A.Y. 2014-15, no deduction shall be allowed in respect of any sum contributed by way of cash.

10.44 DEDUCTION IN RESPECT OF INTEREST ON DEPOSITS IN SAVINGS ACCOUNT

Section:- 80TTA

(1) Eligible assessee: Individual or Hindu Undivided Family

(2) Amount of deduction : Upto Rs. 10,000 in aggregate in respect of any income by way of interest on deposits (not being time deposits) in a savings account with —

(a) a banking company;

(b) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or

(c) a post office.

(3) Other points to be kept in mind:

(a) The deduction under this section is not available in respect of interest on time deposits

(b) Under section 10(15) (i), post office savings bank interest is exempt up to Rs. 3,500 (in an individual account) and Rs, 7,000 (in a joint account).

10.45 DEDUCTION IN CASE OF A PERSON WITH DISABILITY

Section:- 80U

(1) Eligible assessee: Resident Individual who is certified by the medical authority to be a person with disability or severe disability.

(2) Amount of deduction –

Type of person	Amount of deduction (Rs.)
Person suffering with disability	75,000
Person suffering with severe disability	1,25,000

(3) Meaning of certain terms

(a) Person with disability means the individuals who suffers 40 per cent or more than 40 per cent of any disability given below—

- blindness;
- low vision;
- leprosy-cured;
- hearing impairment;
- locomotor disability;
- mental retardation;
- mental illness.

(b) Person with sever disability means the individuals who suffers 80 percent or more of one or more disabilities mentioned above.

11 – COMPUTATION OF TOTAL INCOME AND TAX LIABILITY

11.1 RATES OF INCOME TAX

Section:-

(1) Individual/ HUF/ AOP / BOI and every artificial juridical person

Level of Total Income	Rate of income-tax
Where the total income	
- **Does not exceed Rs. 2,50,000**	Nil
- **Exceeds Rs. 2,50,000 but does not exceed Rs. 5,00,000**	5% of the amount by which the total income exceeds Rs. 2,50,000
- **Exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000**	Rs. 12,500 plus 20% of the amount by which the total income exceeds Rs. 5,00,000
- **Exceeds Rs. 10,00,000**	Rs. 1,12,500 plus 30% of the amount by which the total income exceeds Rs. 10,00,000

(2) For resident individuals of the age of 60 years or more but less than 80 years at any time during the previous year.

Level of total income	Rate of income-tax
Where the total income	
- **Does not exceed Rs. 3,00,000**	Nil
- **Exceeds Rs. 3,00,000 but does not exceed Rs. 5,00,000**	5% of the amount by which the total income exceeds Rs. 3,00,000
- **Exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000**	Rs. 10,000 plus 20% of the amount by which the total income exceeds Rs. 5,00,000
- **Exceeds Rs. 10,00,000**	Rs. 1,10,000 plus 30% of the amount by which the total income exceeds Rs. 10,00,000

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

Level of total income	Rate of income-tax
Where the total income	
- **Does not exceed Rs. 5,00,000**	Nil
- **Exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000**	20% of the amount by which the total income exceeds Rs. 5,00,000
- **Exceeds Rs. 10,00,000**	Rs. 1,00,000 plus 30% of the amount by which the total income exceeds Rs. 10,00,000

(4) Circular No. 28/2016, dated 27-07-2016

Clarification regarding attaining prescribed age of 60 years/80 years on 31st March itself, in case of senior/very senior citizens whose date of birth falls on 1st April

- **The Supreme Court in the case of Prabhu Dayal Sesma vs. State of Rajasthan &, another 1986, AIR, 1948 observed that while counting the age of the person, whole of the day should be reckoned and it starts from 12 o'clock in the midnight and he attains the specified age on the day preceding, the anniversary of his birthday.**
- The CBDT has, vide this Circular, clarified that a person born on 1st April would be considered to have attained a particular age on 31st March, the day preceding the anniversary of his birthday.
- Therefore, a resident individual whose 60th birthday / 80th birthday falls on 1st April, 2018, would be treated as having attained the age of 60 years in the P.Y.2017-18, and would be eligible for higher basic exemption limit of Rs. 3 lakh/Rs. 5 lakh in computing his tax liability for A.Y.2018-19.

11.2 SURCHARGE AND MARGINAL RELIEF

The rates of surcharge applicable for A.Y. 2018-19 are as follows –

Surcharge (as a percentage of income tax)-	**If total income is**	**If total income is in the range of**	**If total income is**
	Upto Rs.50 lakhs	**Rs.50 lakhs to Rs.1 crore**	**Above Rs.1 crore**
Individuals/HUF/AOP/BOI/artificial juridical person	Nil	10%	15%

The above surcharge is subject to a Marginal relief

Why there is a need for marginal relief?

Consider Example (A) and (B)

Example : (A) Taxpayer : Mr. Active, 54 years having total income of Rs.50,00,000.

Particulars	**Rs.**
Tax on Rs.50,00,000	13,12,500
Add: Surcharge	Nil
Sub-total	13,12,500

Example : (B) Taxpayer: Mr. Passive, 55 years having total income of Rs.50,50,000.

Particulars	**Rs.**
Tax on Rs.50,50,000	13,27,500
Add: Surcharge (10%)	1,32,750
Sub-total	14,60,250

Now, as compared to Example (A), in Example (B), income is increased by **Rs. 50,000,** while tax is increased by Rs.**1,47,750,** therefore, there is a need for marginal relief.

Under marginal relief, **tax liability of Rs. 50,50,000 is restricted as under**:-

Tax on 50,50,000	= Tax on 50,00,000 + (Total Income – Rs.50,00,000)
	= Tax on 50,00,000+ (50,50,000-Rs.50,00,000)
	= 13,12,500 + 50,000
	= 13,62,500

The above tax is increased by education cess 3%

☺ EASY STEPS to compute Final tax liability when total income of Individual ranges between Rs.50,00,001 to Rs. 1,00,00,000.

Step 1: Find out regular tax liability + Surcharge (Ignore education cess)
Step 2: Find out tax on 50,00,000 + (Total Income-50,00,000)
Step 3: Step 1 or Step 2 whichever is lower
Step 4: Add Education Cess (@3%)

Practical 1

Find out tax payable of Mr. Jayesh, 51 years, having total income of Rs. 51,00,000.

Solution

Step 1:- Tax on 51,00,000 = Rs. 13,42,500

+ Surcharge (10%) = Rs. 1,34,250

Rs. 14,76,750

Step 2:- Tax on 50,00,000 + (51,00,000 – 50,00,000)

= Rs. 13,12,500 + Rs. 1,00,000

=Rs. 14,12,500

Step 3:-	Step 1 or Step 2 whichever is lower i.e.	Rs. 14,12,500
Step 4:-	Add education cess (3% of 30,25,000)	Rs. 42,375
	Tax Payable	Rs. 14,54,875
	Tax Payable (Rounded off)	**Rs. 14,54,880**

Reader's Note:

11.3 EDUCATION CESS / SECONDARY AND HIGHER EDUCATION CESS ON INCOME-TAX

"Education cess (EC)" is to be calculated at the rate of 2% of income-tax and surcharge. Similarly, "Secondary and higher education cess on income-tax (SHEC)" is to be computed @1% of income-tax and surcharge. EC and SHEC is applicable to all assessees i.e., individuals, HUFs, AOP/BOIs, co-operative societies, firms, LLPs, local authorities and companies. The format of computation of EC and SHEC is as under:-

(a) Income Tax	XXXXX
(b) Add: Surcharge on Income Tax (if any)	XXXXX
(c) Sub-Total (a+b)	XXXXX
(d) Education cess @ 2% on (c)	XXXXX
(e) Secondary and higher education cess on@ 1% on (c)	XXXXX
(f) Total Tax payable (c+d+e)	XXXXX

No marginal relief would be available in respect of such cess.

11.4 REBATE

Section:- 87A

(a) Section 87A has been inserted to provide a rebate from the tax payable (before education cess) by an individual who is resident in India, provided his total income **does not exceed** Rs.5,00,000 **[Rs. 3,50,000 w.e.f. A.Y. 2018-19].**

(b) Such rebate shall be the amount of **income-tax payable** on the total income **or** an amount of Rs. 5,000 ***[Rs. 2,500 W.e.f. A.Y. 2018-19]*** **whichever is less.**

Practical 2

The gross total income of Mr. X, a resident aged 30 years, comprises of salary (Rs.3,85,000) and interest on savings bank (Rs.8,000). Compute his tax liability, assuming that he had deposited Rs.50,000 in public provident fund.

Solution

Computation of total income of Mr. X

Particulars	Rs.	Rs.
Salary		3,85,000
Interest on savings bank account		8,000
Gross Total Income		3,93,000
Less: Deductions under chapter VIA		
Section 80C (deposit in PPF)	50,000	
Section 80TTA (interest on savings bank account)	8,000	58,000
Total Income		**3,35,000**

Computation of tax liability of Mr. X

Particulars	Rs.
Tax on total income @ 5% of Rs.85,000 (Rs.3,35,000-Rs.2,50,000)	4,250
Less: Rebate under 87A	(2,500)
	1,750
Add: Education cess @2%	35
Secondary and higher education cess @ 1%	18
Total tax liability	**1,803**
Total tax liability (Rounded off)	**1,800**

Reader's Note:

11.5 TAX ON LONG TERM CAPITAL GAIN

Section:- 112

(1) Generally Long Term Capital Gain shall be taxed at 20% under section 112. However, if other incomes are less than exemption limit, then to that extent long term capital gain shall be shifted to other income and remaining long term capital gain shall be taxed at 20%. **[This is called Shifting Benefit].**

Practical 3

Mr. X, resident, 35 years, has only income from business:- Rs.12,00,000. Compute his tax liability.

Solution

Here Total Income is Rs. 12,00,000

Tax liability as per slab is worked out as under:

Particulars	Tax Rate	Tax Liability (Rs.)
Upto Rs.2,50,000	Nil	Nil
Rs.2,50,000 to Rs.5,00,000	5%	12,500
Rs.5,00,000 to Rs. 10,00,000	20%	1,00,000
Above Rs.10,00,000 (Here Rs.2,00,000)	30%	60,000
Sub Total		**1,72,500**
Less: Rebate under section 87A (NA because TI>Rs.3,50,000)		Nil
Balance		**1,72,500**
Add: Education Cess	3%	5,175
Total Tax Liability		**1,77,675**
Total Tax Liability (Rounded off)		**1,77,680**

Reader's Note:

Practical 4

Mr. X, resident, 34 years, has following incomes:-

Particulars	Rs.
Business Income	11,50,000
Long Term Capital Gain	1,00,000
Amount invested in PPF	50,000

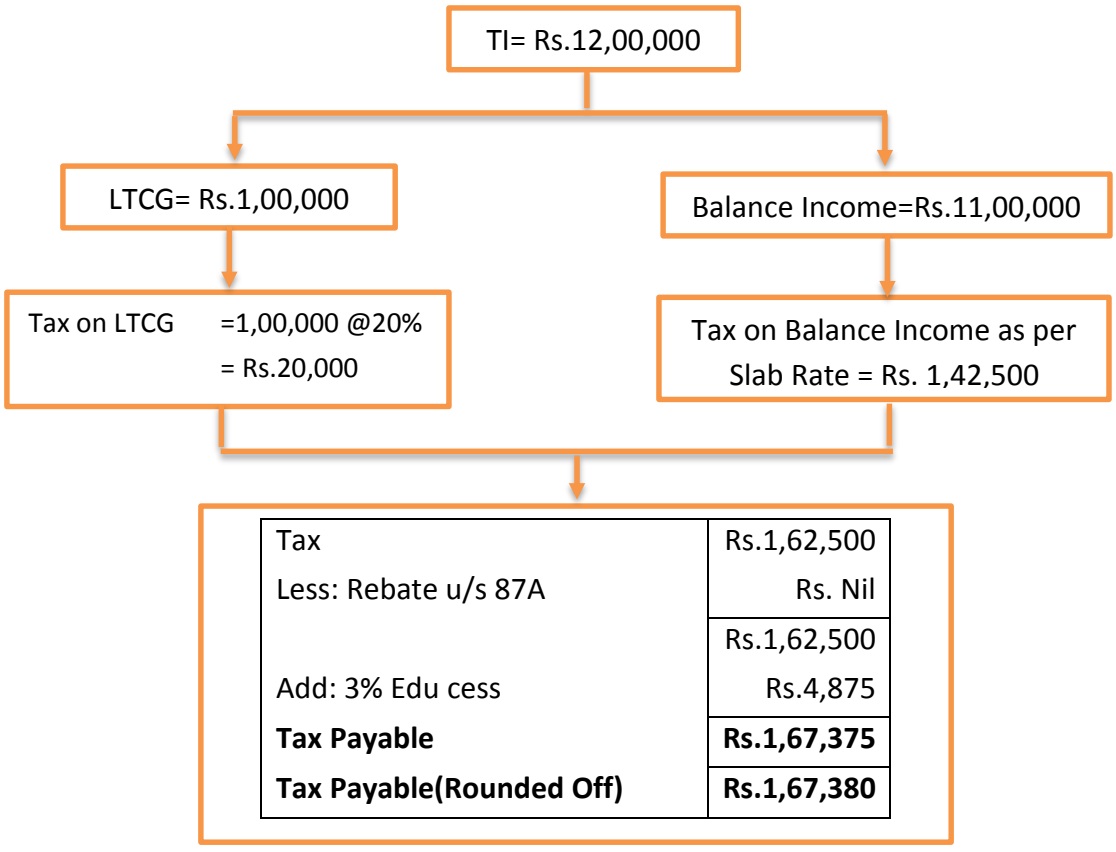
Compute his tax liability.

Solution

Computation of Total Income of Mr. X

Particulars	Rs.
Income under the head PGBP	11,50,000
Long term capital gain	1,00,000
Gross Total Income	12,50,000
Less : Deduction u/s 80C	50,000
TOTAL INCOME	**12,00,000**

Computation of Tax Liability



Tax	Rs.1,62,500
Less: Rebate u/s 87A	Rs. Nil
	Rs.1,62,500
Add: 3% Edu cess	Rs.4,875
Tax Payable	**Rs.1,67,375**
Tax Payable(Rounded Off)	**Rs.1,67,380**

Reader's Note:

Practical 5

Mr. X, resident, 40 years, has only income from business:- Rs.3,40,000. Compute his tax liability.

Solution

Here Total Income is Rs. 3,40,000

Tax liability as per slab is worked out as under:

Particulars	Tax Rate	Tax Liability (Rs.)
Upto Rs.2,50,000	Nil	Nil
Rs.2,50,000 to Rs.3,40,000	5%	4,500
Sub Total		**4,500**
Less: Rebate under section 87A		(2,500)
Balance		**2,000**
Add: Education Cess	3%	60
Total Tax Liability		**2,060**

Reader's Note:

Practical 6

Mr. Mohan provides the following information:

Particulars	Rs.
Income under the head house property	2,70,000
Long term capital gain	1,00,000
Contribution to Public Provident Fund	30,000

Calculate tax liability of Mr. Mohan under following alternatives

(1) If he is resident. (2) If he is non-resident.

Solution

Computation of Total Income of Mr. Mohan

Particulars	Rs.
Income under the head house property	2,70,000
Long term capital gain	1,00,000
Gross Total Income	3,70,000
Less : Deduction u/s 80C: Contribution to PPF	(30,000)
TOTAL INCOME	**3,40,000**

Computation of Tax Liability

Alternative (1):- If Mr. Mohan is resident

TI= Rs. 3,40,000

Long Term Capital Gain

LTCG	Rs.1,00,000
Less: Shifting Benefit **(Refer Note 1)**	(Rs. 10,000)
Taxable LTCG @20%	Rs.90,000

Tax on LTCG =90,000 x 20% =18,000

Balance Income

Balance Income	Rs.2,40,000
Add: Shifting Benefit	Rs. 10,000
Income subject to Slab Rate	Rs.2,50,000

Tax on Balance Income = Nil

Tax	Rs.18,000
Less: Rebate u/s 87A **(Refer Note 2)**	(Rs. 2,500)
	Rs.15,500
Add: 3% Edu cess	Rs.465
Tax Payable	**Rs.15,965**
Tax Payable (Rounded off)	**Rs.15,970**

NOTES:

1. Generally Long Term Capital Gain shall be taxed at 20% under section 112. However, if other incomes are less than exemption limit, then to that extent long term capital gain shall be shifted to other income and balance long term capital gain shall be taxed at 20%.

2. Here total income doesn't exceed Rs.3,50,000 and Mr. Mohan being resident individual, therefore he can avail rebate under section 87A which shall be Rs. 18,000 or Rs.2,500 whichever is less.

Alternative (2):- If Mr. Mohan is non-resident

TI= Rs. 3,40,000

Long Term Capital Gain

LTCG	Rs.1,00,000
Less: Shifting Benefit **(Refer Note 1)**	Not Available
Taxable LTCG @20%	Rs.1,00,000

Tax on LTCG =1,00,000 x 20% =20,000

Balance Income

Balance Income	Rs.2,40,000
Add: Shifting Benefit	Nil
Income subject to Slab Rate	Rs.2,40,000

Tax on Balance Income = Nil

Tax	Rs.20,000
Less: Rebate u/s 87A **(Refer Note 2)**	Not Available
	Rs.20,000
Add: 3% Edu cess	Rs.600
Tax Payable	**Rs.20,600**

NOTES:

1. Non-resident cannot avail shifting benefit.
2. Non-resident cannot avail rebate under section 87A.

Reader's Note:

Practical 7

Mr. X, resident, 62 years has following incomes:

Particulars	Rs.
Long Term Capital Gain	10,00,000
Pension Income	90,000
Contribution to Public Provident Fund (PPF).	70,000
Life Insurance Policy Premium	82,000

Compute his tax liability

Solution

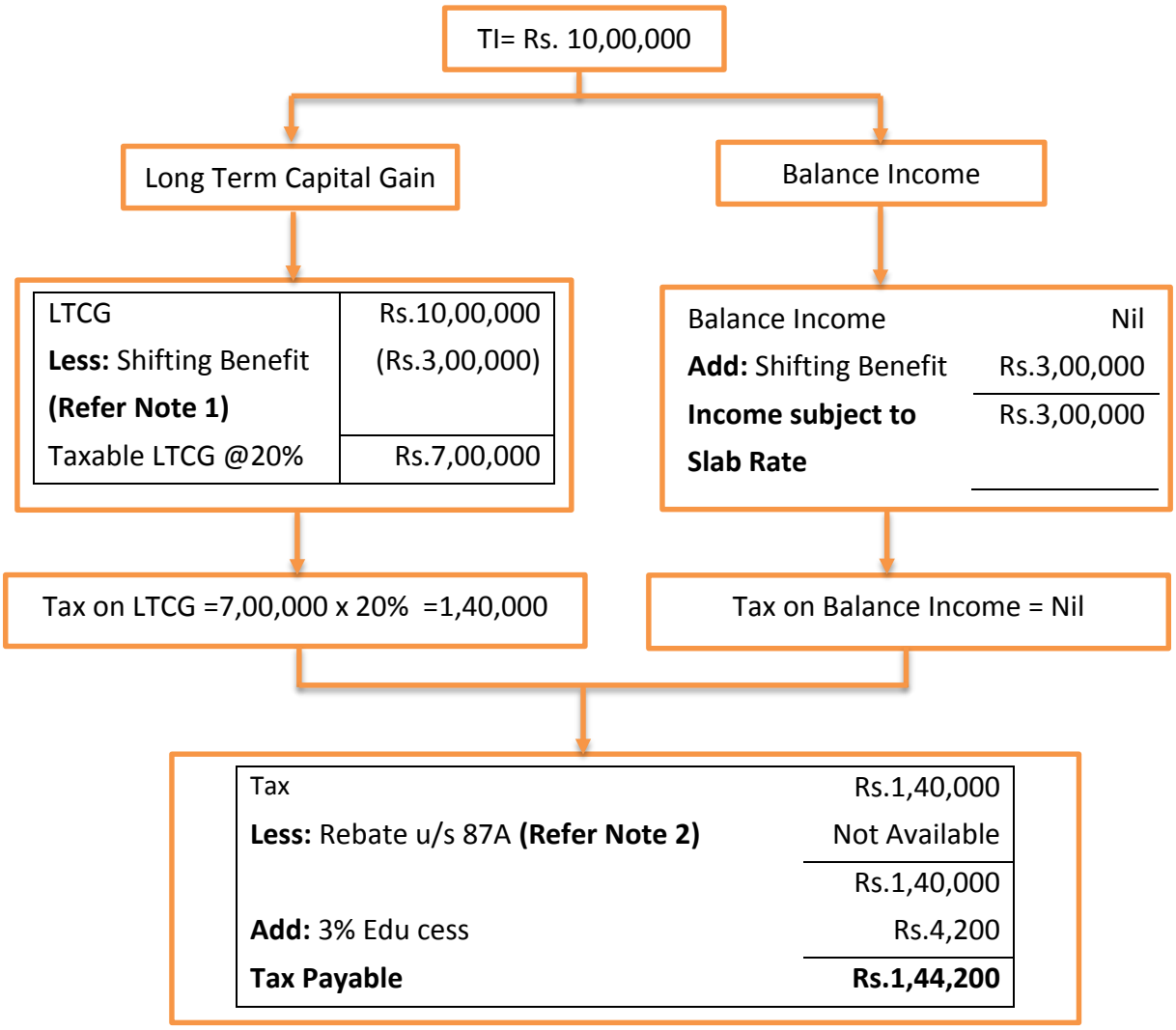
Computation of Total Income

Particulars	Rs.
Income under the head Salary (Pension)	90,000
Long term capital gain	10,00,000
Gross Total Income	10,90,000
Less : Deduction u/s 80C: (Refer Note)	(90,000)
TOTAL INCOME	**10,00,000**

Note:

1. First of all, contribution to PPF and payment of LIC qualifies for deduction under section 80C. Therefore, total amount that qualifies under Section 80 C is Rs. 70,000 + Rs. 82,000 = Rs. 1,52,000.
2. However, maximum amount of deduction that can be availed under section 80C is Rs. 1,50,000. Therefore, claim under section 80C is restricted to Rs. 1,50,000.
3. Further, no deduction can be claimed under section 80 C to 80 U against long-term capital gain. Therefore, claim u/s 80C is further restricted to remaining income (here, pension income) i.e.Rs.90,000.

Computation of Tax Liability



NOTES:

1. Generally Long Term Capital Gain shall be taxed at 20% under section 112. However, if other incomes are less than exemption limit (Here Rs.3,00,000 because Mr. X is senior citizen), then to that extent long term capital gain shall be shifted to other income and balance long term capital gain shall be taxed at 20%
2. Here total income exceeded Rs.3,50,000, therefore Mr. X cannot avail rebate under section 87A.

Reader's Note:

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(2) In following cases option is available to tax long term capital gain at 10% instead of 20%

(a) Listed shares

(b) Listed securities

(c) Zero coupon bond (whether listed or not)

Option I- Compute capital gain as per general rules and tax the same @20%

Option II-Compute capital gain without indexation and tax the same @10%

Practical 8

During the previous year, X (age 31 years),resident, sells the following assets-

	Equity Shares of A Ltd. (Listed) (Rs.)	Equity Shares of B Ltd. (Listed) (Rs.)	Equity Shares of C Ltd. (Not listed) (Rs.)
Sale Consideration	5,00,000	10,25,000	6,89,000
Cost of Acquisition	26,000	1,10,000	20,000
Indexed Cost of Acquisition	2,42,293	9,51,280	1,62,557

Income of X from other sources is Rs.7,86,000. X deposits Rs.50,000 in public provident fund. Find out the total income and tax liability assuming that the listed shares are transferred outside a stock exchange. (ICWA – Dec 2004 modified)

Solution

Computation of Total Income of Mr. X

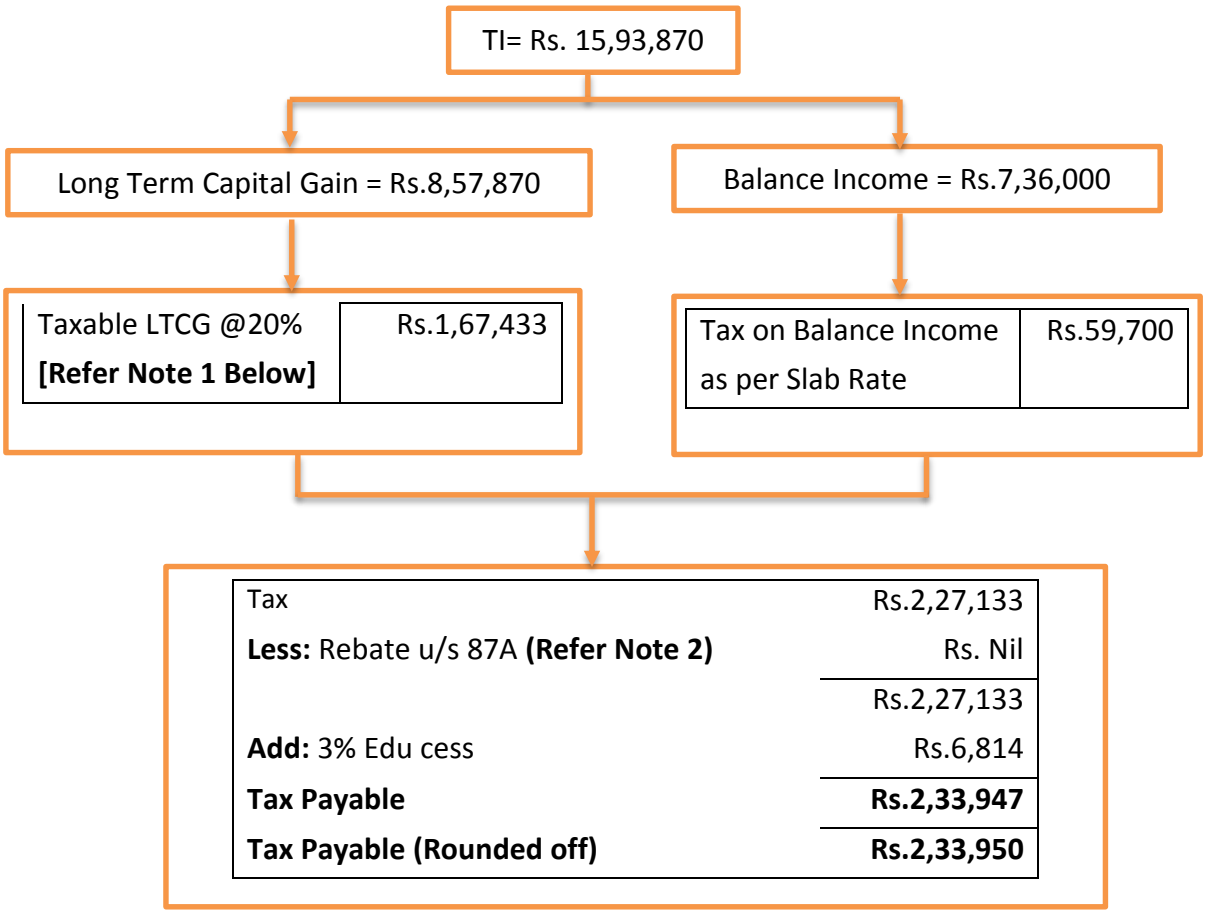
Particulars	Rs.
Income under the head Capital Gain (Refer Note)	8,57,870
Income from other source	7,86,000
Gross Total Income	**16,43,870**
Less : Deduction u/s 80C	(50,000)
TOTAL INCOME	**15,93,870**

Note 1: Computation of Capital Gain

Particulars	Equity Shares of A Ltd. (Listed) (Rs.)	Equity Shares of B Ltd. (Listed) (Rs.)	Equity Shares of C Ltd. (Not listed) (Rs.)
Sale Consideration	5,00,000	10,25,000	6,89,000
Less: Indexed cost of Acquisition	2,42,293	9,51,280	1,62,557
Long Term Capital Gain	2,57,707	73,720	5,26,443

Total Long Term Capital Gain = Rs. 2,57,707 + Rs. 73,720 + Rs. 5,26,444 = Rs.8,57,870

Computation of Tax Liability



NOTES:

1. Computation of Tax on Long Term Capital Gain

Particulars	Equity Shares of A Ltd. (Listed)	Equity Shares of B Ltd. (Listed)	Equity Shares of C Ltd. (Not listed)
Option 1			
Capital Gain after Indexation	2,57,707	73,720	5,26,443
Tax @ 20% on above	**51,541**	**14,744**	**1,05,289**
Option 2			Not Available because Shares are not listed
Capital Gain without Indexation	Rs. 4,74,000 (Rs.5,00,000-Rs.26,000)	Rs. 9,15,000 (Rs.10,25,000-Rs.1,10,000)	NA
Tax @ 10% on above	**Rs. 47,400**	**Rs. 91,500**	**NA**
Final Tax liability selecting better option	**Rs. 47,400**	**Rs.14,744**	**Rs.1,05,289**

Total Tax on Long Term Capital Gain = Rs. 47,400 + Rs.14,744 + Rs. 1,05,289 = Rs. 1,67,433

2. Here total income exceeded Rs.3,50,000, therefore Mr. X cannot avail rebate under section 87A.

Reader's Note:

11.6 SECURITY TRANSACTION TAX (STT) AND ITS IMPACT ON INCOME TAX CALCULATION.

Section:- 56(1)

(1) Security Transaction Tax is applicable in respect of followings:-

(a) Sale or purchase of equity shares/equity oriented mutual fund through stock exchange
(b) Sale of equity oriented mutual fund to mutual fund

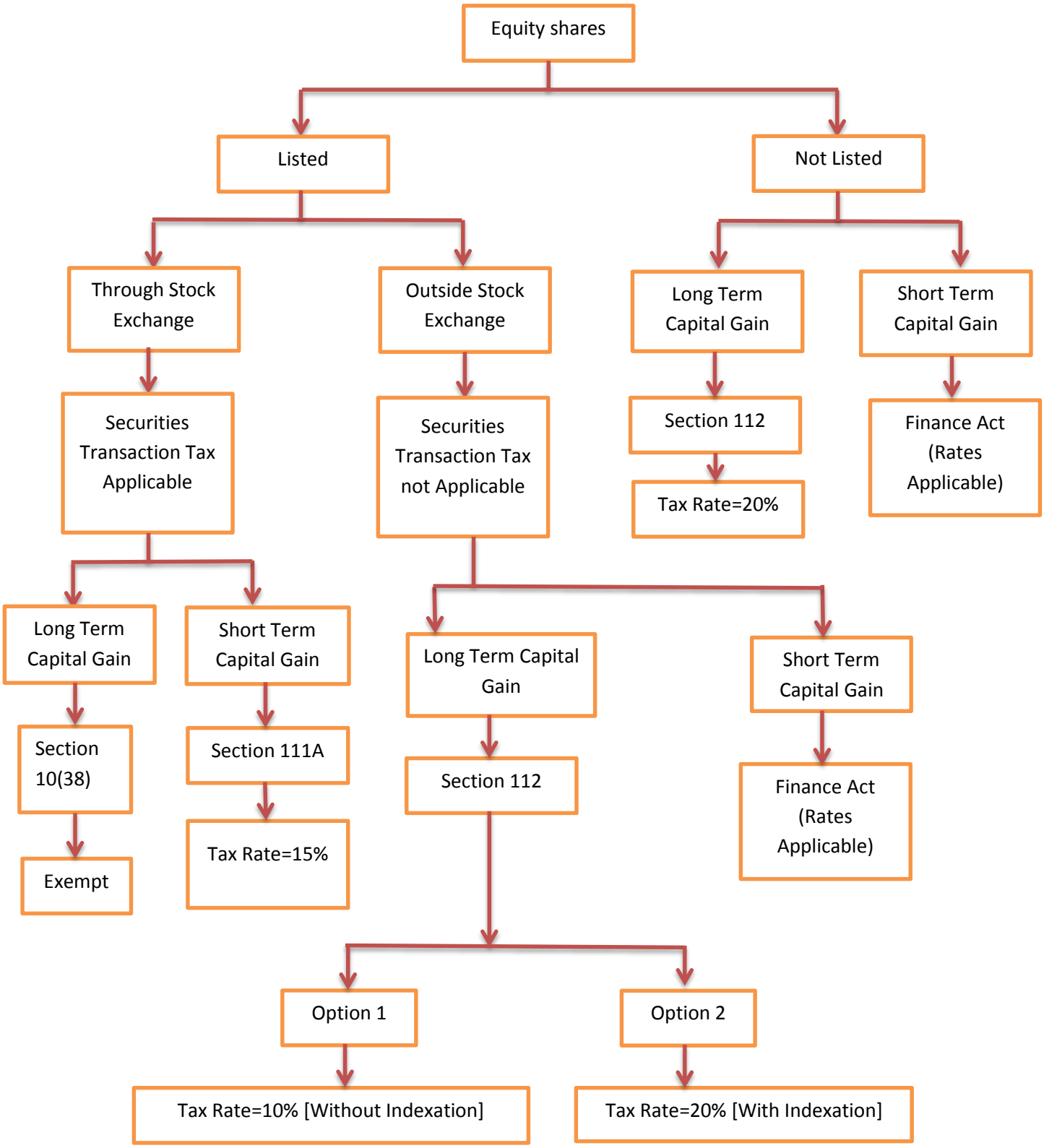
(2) Impact of STT on the Head "Capital Gain"

(a) While computing capital gain, security transaction tax will not be allowed as deduction, either as an expense of transfer or as a part of purchase cost.
(b) Long Term Capital Gain which has suffered STT is fully exempt from tax under section 10(38)
(c) Short Term Capital Gain which has suffered STT shall be taxed at 15% under section 111A. Shifting benefit is available.

(3) Impact of STT on the Head "PGBP"

While computing business income, security transaction tax incurred on purchase or sale of tax shall be allowed as deduction.

Analysis



Practical 9

Mr. X, resident, 26 years has earned following incomes:

Particulars	Rs.
Short Term Capital Gain	4,22,000
Short Term Capital Gain u/s 111A	1,20,000
Amount invested in PPF	12,000

Compute his tax liability.

Solution

Computation of Total Income of Mr. X

Particulars	Rs.
Short Term Capital Gain	4,22,000
Short Term Capital Gain u/s. 111A	1,20,000
Gross Total Income	**5,42,000**
Less : Deduction u/s 80C	12,000
TOTAL INCOME	**5,30,000**

Computation of Tax Liability

TI= Rs. 5,30,000

Short Term Capital Gain u/s 111A = Rs.1,20,000

Taxable STCG @15%	Rs. 18,000

Balance Income = Rs.4,10,000

Tax on Balance Income as per Slab Rate	Rs.8,000

Tax	Rs.26,000
Less: Rebate u/s 87A **(Refer Note 2)**	Rs. Nil
	Rs.26,000
Add: 3% Edu cess	Rs.780
Tax Payable	**Rs.26,780**

Reader's Note:

Practical 10

Mr. X, resident, 22 years has earned following incomes:

Particulars	Rs.
Business Income	1,52,000
Short Term Capital Gain u/s 111A	1,48,000
Amount invested in PPF	10,000

Compute his tax liability.

Solution

Computation of Total Income of Mr. X

Particulars	Rs.
Short Term Capital Gain	1,52,000
Short Term Capital Gain u/s. 111A	1,48,000
Gross Total Income	**3,00,000**
Less : Deduction u/s 80C	10,000
TOTAL INCOME	**2,90,000**

Computation of Tax Liability

TI= Rs. 2,90,000

Short Term Capital Gain u/s 111A

STCG u/s 111A	Rs.1,48,000
Less: Shifting Benefit **(Refer Note 1)**	(Rs.1,08,000)
Taxable STCG @15%	Rs.40,000

Tax on STCG u/s 111A=40,000x15% =6,000

Balance Income

Balance Income	Rs.1,42,000
Add: Shifting Benefit	Rs.1,08,000
Income subject to Slab Rate	Rs.2,50,000

Tax on Balance Income = Nil

Tax	Rs.6,000
Less: Rebate u/s 87A **(Refer Note 2)**	(Rs.2,500)
	Rs.3,500
Add: 3% Edu cess	Rs.105
Tax Payable	**Rs.3,605**
Tax Payable (Rounded off)	**Rs.3,610**

NOTES:

1. Generally Short Term Capital Gain which suffered security transaction tax shall be taxed at 15% under section 111A. However, if other incomes are less than exemption limit, then to that extent such short term capital gain shall be shifted to other income and balance short term capital gain shall be taxed at 15%.
2. Here total income doesn't exceed Rs.3,50,000 and Mr. X, being resident individual, therefore he can avail rebate under section 87A which shall be Rs. 6,000 or Rs.2,500 whichever is less.

Reader's Note:

11.7 TAX ON WINNINGS FROM LOTTERIES, CROSSWORD PUZZLES ETC.

Section:- 115BB

1. As per section 115BB read with section 58(4), gross winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any nature whatsoever are chargeable to income-tax at a flat rate of 30 per cent.
2. No expenditure or allowance can be claimed against such income.
3. No deduction can be claimed against such income under section 80C to 80 U.
4. Benefit of set-off of loss under any head against such winnings is not available.
5. Shifting benefit is also not available against such winnings.
6. The above provision shall not apply to an income from the activity of owning and maintaining race horses.

Practical 11

Mr. X, resident, has only income by way of winning from lottery:- Rs.50,000. Compute his tax liability.

Solution

Here Total Income is Rs.50,000

Computation of Tax liability

Particulars	**Rs.**
Tax @30% on Rs.50,000	15,000
Less: Rebate under section 87A (TI≤ Rs.3,50,000)	(2,500)
	12,500
Add: Education Cess	375
Total Tax Liability	**12,875**
Total Tax Liability (Rounded off)	**12,880**

Reader's Note:

Practical 12

Suppose in the above problem, he invested Rs.10,000 to provident fund. Find out his tax liability.

Solution

No deduction under section 80C to 80 U can be claimed against winning from lottery income. Therefore, total income and tax liability will remain same as per the solution of earlier sum.

Reader's Note:

Practical 13

Mr. X, resident, 21 years has earned following incomes:-

Particulars	**Rs.**
Short Term Capital Gain	60,000
Long Term Capital Gain	1,90,000
Winning from horse race	50,000
Contribution to PPF	20,000

Compute his tax liability.

Solution

Computation of Total Income

Particulars	Rs.
Short Term Capital Gain	60,000
Long Term Capital Gain	1,90,000
Winning from horse race	50,000
Gross Total Income	**3,00,000**
Less: Deduction u/s 80C - Contribution to PPF	20,000
Total Income	**2,80,000**

Computation of Tax Liability

TI= Rs. 2,80,000

LTCG

LTCG	Rs.1,90,000
Less: Shifting Benefit	(Rs.1,90,000)
Taxable LTCG @20%	Nil

Tax on LTCG=Nil

Winning from Horse Race

Winning from Horse Race	Rs.50,000
Less: Shifting Benefit	NA
Taxable@30%	Rs.50,000

Tax on winning from Horse Race = Rs.15,000

Balance Income

Balance Income	Rs.40,000
Add: Shifting Benefit (LTCG)	Rs.1,90,000
Income subject to Slab Rate	Rs.2,30,000

Tax on Balance Income = Nil

Tax	Rs.15,000
Less: Rebate u/s 87A **(Refer Note 2)**	(Rs.2,500)
	Rs.12,500
Add: 3% Edu cess	Rs.375
Tax Payable	**Rs.12,875**
Tax Payable (Rounded off)	**Rs.12,880**

Reader's Note:

11.8 TAX ON INCOME REFERRED TO IN SECTION 68 OR SECTION 69 OR SECTION 69A OR SECTION 69B OR SECTION 69C OR SECTION 69D.

Section:- 115BBE

1. As per section 115BBE, income from undisclosed sources (i.e. Section 68, Section 69, Section 69A, Section 69B, Section 69C or Section 69D) are chargeable to income-tax at a flat rate of 60 per cent (Plus Surcharge @ 25%). This surcharge @25% is payable by all assessee irrespective of their residential status or quantum of income.
2. No expenditure or allowance can be claimed against such income.
3. Benefit of set-off of loss under any head against such incomes is not available.
4. Shifting benefit is also not available for such incomes.

Practical 14

Mr. X, resident, filed return for the **A.Y. 2018-19** declaring non-speculative business loss of Rs.55,50,000. However, the assessing officer made an addition of Rs. 6,00,000 on account of unexplained cash credit under section 68 of the Act. Mr. X denies tax liability on the ground that he is entitled for set-off of loss against the addition made by assessing officer. Whether claim made by Mr. X is correct? Also find out tax payable by Mr. X, if any.

Solution

Considering the above amendment, the claim made by Mr. X regarding set-off of loss against addition made by the assessing officer under section 68 is not tenable.

Computation of Tax Liability of Mr. X

	Particulars	Rs.
	Unexplained cash credit u/s 68	6,00,000
	Total Income	**6,00,000**
	Tax @ 60%	**3,60,000**
Less	Surcharge (25%)	90,000
	Sub-Total	**4,50,000**
Add:	Education Cess @ 3%	13,500
	Tax Liability	**4,63,500**

Reader's Note:

11.9 CONCESSIONAL TAXATION REGIME FOR ROYALTY INCOME IN RESPECT OF PATENT DEVELOPED AND REGISTERED IN INDIA

Section:- 115BBF

(5) Section 115BBF provides that where the total income of the **eligible assessee** includes any income by way of **royalty** in respect of a **patent** developed and registered in India, then such royalty shall be taxable at the rate of 10%

(6) No deduction for any expenditure or allowance in respect of such royalty income shall be allowed under the Act.

(7) Shifting benefit is also not available on such income.

(8) For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(9) This section is optional.

(10) The eligible assessee is required to exercise the option for taxation of income by way of royalty in respect of a patent developed and registered in India in accordance with the provisions of section 115BBF in the prescribed manner, on or before the due date of furnishing return of income under section 139(1).

(11) Where an eligible assessee opts for taxation of income by way of royalty in respect of a patent developed and registered in India for any previous year in accordance with section 115BBF, and the assessee offers the income for taxation for any of the five assessment years relevant to the previous year succeeding the previous year not in accordance with section 115BBF(1), then the assessee shall not be eligible to claim the benefit of section 115BBF for five assessment years subsequent to the assessment year relevant to the previous year in which such income has not been offered to tax in accordance with section 115BBF(1).

(12) For the purpose of this section,

(1) <u>Eligible assessee means:</u>

- A person resident in India,
- who is the true and first inventor of the invention and
- whose name is entered on the patent register as the patentee in accordance with Patents Act, 1970.

(2) <u>Meaning of royalty:</u>

"Royalty", in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains" or consideration for sale of product manufactured with the use of patented process or the patented article for commercial use) for the—

(a) transfer of all or any rights (including the granting of a licence) in respect of a patent; or

(b) imparting of any information concerning the working of, or the use of, a patent; or

(c) use of any patent; or

(d) rendering of any services in connection with the activities referred to in (1) to (3) above.

(3) <u>Meaning of Patent:</u>

"Patent" shall have the meaning assigned to it in section 2(1)(m) of the Patents Act.

11.10 TAX ON INCOME FROM TRANSFER OF CARBON CREDITS.

Section:- 115BBG

1. As per the provisions of section 115BBG, income by way of transfer of carbon credits shall be charged to tax at a flat rate of 10 percent.

2. No expenditure or allowance can be claimed against such income.

3. Shifting benefit is also not available on such income

Explanation.—*For the purposes of this section, "carbon credit" in respect of one unit shall mean reduction of one tonne of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price.*

11.11 DEFINITION OF AGRICULTURAL INCOME

Section:- 2(1A)

"Agricultural income means"

1. Any rent or revenue derived from land which is situated in India and is used for agricultural purposes
2. Any income derived from such land by agriculture operations.
3. Any income derived by processing of agricultural produce by the cultivator or receiver of rent in kind. [such process shall be ordinarily employed to render the produce fit for the market]
4. Any income derived from the sale by a cultivator or receiver of rent in kind of the produce raised or received by him.
5. Income derived from any building if it fulfills the following conditions:
   - It shall be occupied by the cultivator or receiver of rent or revenue.
   - The building is on or in the immediate vicinity of the agricultural land.
   - It is used as dwelling house or storehouse or out house.
   - The land is assessed to land revenue or it is not situated within the limits of urban area or specified kilometers from urban area.
6. With effect from A.Y. 2009-10, any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

11.12 GUIDING PRINCIPLES ON THE SCOPE OF TERM "AGRICULTURE" AND "AGRICULTURAL PURPOSES"

CIT v. RAJA BENOY KUMAR SAHAS ROY (SC)

- **Basic operations and Subsequent Operations are must to qualify as agriculture income.**

  Basic operations: Prior to germination, some basic operation is essential to constitute agriculture. The basic operations would involve expenditure of human skill and labour upon the land itself and not merely on the growths from the land. Some illustrative instances of such operations are tilling of land, sowing of the seeds, planning and similar operations on the land.

  Subsequent operations: Besides the basic operations, there are certain subsequent operations, which are performed after the produce sprouts from the land. Illustrative instances of subsequent operations are weeding, digging the soil around the growth, removal of undesirable under-growths and all operations which foster the growth and preserve the same not only from insects and pests but also from depreciation from outside, tending, pruning, cutting, harvesting and rendering the produce fit for the market.

  As a result, Income from sale of forest produce (spontaneous growth) where basic operations are missing, cannot be termed as agricultural income.

- **Agriculture not merely includes food and grains, it also includes fruits, vegetables, luxury and commercial crops too.**

  Agriculture does not merely imply raising of food and grains for the consumption of men and animals; it includes all products from the performance of basic as well as subsequent operations on land. These products, for instance , may be grain or vegetable or fruits including plantation and groves, grass or pasture for consumption of beasts or articles of luxury such as betel, coffee, tea, spices, tobacco, etc., or commercial crops like cotton , flax, jute, hemp, indigo, etc.

- **Mere connection with land is not sufficient to qualify the operations for the term "agricultural purposes".**

  The mere fact that an activity has some connection with or is in some way dependent on land is not sufficient to bring it within the scope of the term "agriculture".

  Therefore, breeding and rearing a livestock, dairy farming, cheese and butter making and poultry farming would not be termed as agricultural purposes.

11.13 SOME EXAMPLES OF AGRICULTURAL INCOME AND NON-AGRICULTURAL INCOME BASED ON COURT RULINGS

Sr. No.	Agricultural Income	Sr. No.	Non-Agricultural Income
(1)	Rental income derived from land in India which is used for agricultural purposes.	(1)	Interest on arrears of rent payable in respect of agricultural land
(2)	Income from growing of flowers and creepers.	(2)	Income from marketing process, fisheries, etc.
(3)	Interest, Salary and share of profit received by partner from a firm engaged in agricultural operations.	(3)	Income from supply of water for irrigation purpose
(4)	Insurance Compensation on account of damage caused to tea garden from hailstorm.	(4)	Income from mining activities
		(5)	Income from forest trees of spontaneous growth of wood bank, leaves, fruits, etc.
		(6)	Income from dairy or poultry farming
		(7)	Dividend paid by a company out of its agricultural income
		(8)	Interest received by a moneylender in form of agricultural produce.
		(9)	Rental income from farm house given for non-agricultural purpose (e.g., shooting purpose)

11.14 COMPUTATION OF AGRICULTURAL INCOME OF AN ASSESSEE WHO IS ENGAGED IN GROWING AND MANUFACTURING TEA, COFFEE OR RUBBER

RULE:- 7A, 7B and 8

First compute composite income under the head PGBP as if entire income is taxable and thereafter it shall be bifurcated in the following manner:-

Rule No.	Nature of Business	Agricultural Income	Non-Agricultural Income
7A	Sale of centrifuged latex or cenex manufactured from rubber	65% of PGBP	35% of PGBP
7B(1A)	Sale of coffee grown, cured, roasted and grounded by seller in India	60% of PGBP	40% of PGBP
7B(1)	Sale of coffee grown and cured by seller in India	75% of PGBP	25% of PGBP
8	Growing and manufacturing tea	60% of PGBP	40% of PGBP

Practical 15

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the relevant previous year.

Sr. No.	Particulars	Rs.
(i)	Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.	3,00,000
(ii)	Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.	1,00,000
(iii)	Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.	2,50,000
(iv)	Income from sale of tea grown and manufactured in Shimla.	4,00,000
(v)	Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land	80,000

You are required to compute the business income and agricultural income of Miss Vivitha.

Solution

Computation of business income and agricultural income of Ms. Vivitha

Sr. No.	Particulars	Gross (Rs.)	Business income		Agricultural Income
			%	Rs.	Rs.
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	1,95,000
(ii)	Sale of coffee grown and cured in India	1,00,000	25%	25,000	75,000
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. (See Note below)	2,50,000	100%	2,50,000	-
(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	2,40,000
(v)	Saplings and seedlings grown in nursery in India.	80,000		Nil	80,000
	Total	**11,10,000**		**5,40,000**	**5,90,000**

Note:- Since agricultural operations are done in Colombo, Sri Lanka (outside India), it shall be fully chargeable to tax. Hence, there is no question of such apportionment and the whole income is taxable as business income.

Reader's Note:

11.15 COMPUTATION OF AGRICULTURAL INOCME OF AN ASSESSEE WHO IS ENGAGED IN GROWING AND MANUFACTURING OTHER THAN TEA, COFFEE OR RUBBER

Rule :- 7

For disintegrating a composite business income which is partly agricultural and partly non-agricultural, the market value of any agricultural produce, raised by the assesse or received by him as rent-in-kind and utilized as raw material in his business, is deducted. No further deduction is permissible in respect of any expenditure incurred by the assesse as a cultivator or receiver of rent-in-kind.

Practical 16

Mr. Dilkush is engaged in growing sugarcane and manufacturing sugar. From the following information, determine agricultural income and business income.

Particulars	(Rs. In lakh)
Cost of cultivating sugarcane	5
Market value of sugarcane when sugarcane was transferred to manufacturing division	11
Manufacturing , selling and admin cost	7.5
Sales turnover of sugar	26.5

Solution

Computation Business Income (Non-Agricultural Income)

Particulars	Non-Agricultural (Rs. In lakh)
Sales turnover of sugar	26.50
Less: Market value of sugarcane when sugarcane was transferred to manufacturing division	(11.00)
Manufacturing , selling and admin cost	(7.50)
Business income	**8.00**

Computation Agricultural Income

Particulars	Agricultural (Rs. In lakh)
Sales turnover of sugarcane (Market Value if sold in open market)	11.00
Less: Cost of cultivating sugarcane	(5.00)
Agricultural Income	**6.00**

Reader's Note:

11.16 AGRICULTURAL INCOME IS EXEMPT FROM INCOME TAX BUT INCOME TAX ACT INDIRECTLY COLLECT TAX ON AGRICULTURAL INCOME

- Agricultural income is exempt from tax under section 10(1). However, it is to be included in total income for determining the rate at which non-agricultural income is chargeable to tax if following **three conditions** are satisfied.
  1. The assessee is an individual, HUF, AOP or BOI or an artificial judicial person.
  2. The agriculture income of the assessee exceeds Rs. 5,000.
  3. The Total Income (non-agriculture income) chargeable as per slab exceeds the maximum amount not chargeable to tax. (i.e. exemption limit)

- Then, procedure for computation of tax payable on non-agricultural income after aggregation of agricultural income is as follows-
  (i) Find out (Total income + Agriculture income)
  (ii) Find out tax on step (i)
  (iii) Find out (Basic Exemption limit + Agricultural Income)
  (iv) Find out tax on step (iii). This amount is termed as rebate on agriculture income.
  (v) Tax payable = (Tax at Step (ii) – Step (iv))
  (vi) Compute surcharge, if any and education cess.

Practical 17

(A) During the previous year, Mr. KJ Shah, 28 years, resident , earned business income of Rs.3,10,000 and Rs. 30,000 under the head "Income from other sources". Compute his tax liability.

(B) Suppose in point (A) above, Mr. KJ Shah also earned an agriculture income of Rs.5,00,000 over and above the business and other source income, what would be his tax liability?

(C) Suppose in point (A) above, Mr. KJ Shah also X has earned an earned an agriculture income of Rs.5,00,000 over and above the business and other source income, what would be his tax liability?

Solution

(A)

Computation of Total Income

Particulars	Rs.
Business Income	3,10,000
Income from other sources	30,000
Gross Total Income	**3,40,000**
Less: Deduction under chapter VI –A	Nil
Total Income	**3,40,000**

Computation of tax liability

Particulars	Rs.
Tax on total income @ 5% of Rs.90,000 (Rs.3,40,000-Rs.2,50,000)	4,500
Less: Rebate under 87A	(2,500)
	2,000
Add: Education cess @2%	40
Secondary and higher education cess @ 1%	20
Total tax liability	**2,060**
Total tax liability (Rounded off)	**2,060**

(B)

Computation of tax liability

Particulars	Tax Rate	Rs.
Total Income		**3,40,000**
Add: Agricultural Income for rate purpose		5,00,000
Sub-total		**8,40,000**
Tax Upto Rs.2,50,000	-	Nil
Rs.2,50,000 to Rs.5,00,000	5%	12,500
Rs.5,00,000 to Rs. 8,40,000	20%	68,000
Tax on Rs.8,40,000		80,500
Less: Rebate on Agricultural Income (Working Note)		(62,500)
Sub-Total		18,000
Less: Rebate u/s 87A		(2,500)
Balance		15,500
Add: Education cess @2%		310
Secondary and higher education cess @ 1%		155
Total tax liability		**15,965**
Total tax liability (Rounded off)		**15,970**

Working Note:- Rebate on Agricultural Income	
Basic Exemption Limit	Rs.2,50,000
Agricultural Income	Rs.5,00,000
Sub-Total	**Rs.7,50,000**
Tax on Rs. 7,50,000	**Rs.62,500**

(C)

Computation of tax liability

Particulars	Tax Rate	Rs.
Total Income		**3,40,000**
Add: Agricultural Income for rate purpose		10,00,000
Sub-Total		**13,40,000**
Tax Upto Rs.2,50,000	-	Nil
Rs.2,50,000 to Rs.5,00,000	5%	12,500
Rs.5,00,000 to Rs.10,00,000	20%	1,00,000
Rs.10,00,000 to Rs.13,40,000	30%	1,02,000
Tax on Rs. 13,40,000		2,14,500
Less: Rebate on Agricultural Income (Working Note)		(1,87,500)
Sub-Total		27,000
Less: Rebate u/s 87A		(2,500)
Balance		24,500
Add: Education cess @2%		490
Secondary and higher education cess @ 1%		245
Total tax liability		**25,235**
Total tax liability (Rounded off)		**25,240**

Working Note : -Rebate on Agricultural Income	
Basic Exemption Limit	Rs.2,50,000
Agricultural Income	Rs.10,00,000
Sub-total	**Rs.12,50,000**
Tax on Rs.12,50,000	**Rs.1,87,500**

Reader's Note:

Practical 18

Mr. Mahesh, aged 35 years, resident provides the following information.

Particulars	Rs.
Business income	4,20,000
Income from other sources	2,80,000
Deduction under section 80C	22,000
Agriculture income	4,00,000

Compute his tax liability.

Solution

Computation of Total Income

Particulars	Rs.
Business Income	4,20,000
Income from other sources	2,80,000
Gross Total Income	**7,00,000**
Less: Deduction under chapter VI –A	(22,000)
Total Income	**6,78,000**
Add: Agricultural Income for rate purpose	4,00,000
Sub- total	**10,78,000**

Computation of Tax Liability

Particulars	Tax Rate	Rs.
Tax upto Rs.2,50,000	-	Nil
Rs.2,50,000 to Rs.5,00,000	5%	12,500
Rs.5,00,000 to Rs.10,00,000	20%	1,00,000
Rs.10,00,000 to Rs.10,78,000	30%	23,400
Tax on Rs.10,78,000		1,35,900
Less: Rebate on Agricultural Income (Working Note)		(42,500)
Sub-Total		93,400
Less: Rebate u/s 87A		Nil
		93,400
Add: Education cess @2%		1868
Secondary and higher education cess @ 1%		934
Total tax liability		**96,202**
Total tax liability (Rounded off)		**96,200**

Working Note:- Rebate on Agricultural Income	
Basic Exemption Limit	Rs.2,50,000
Agricultural Income	Rs.4,00,000
Total	**Rs.6,50,000**
Tax on Rs. 6,50,000	**Rs.42,500**

Reader's Note:

Practical 19

Mr. Gansh, aged 24 years, resident, provides the following information:

Particulars	Rs.
Business income	1,40,000
Agriculture income	5,60,000

Compute his tax liability.

Solution

Computation of Total Income

Particulars	Rs.
Business Income	1,40,000
Gross Total Income	**1,40,000**
Less: Deduction under chapter VI –A	Nil
Total Income	**1,40,000**
Add: Agricultural Income (since total income chargeable as per slab does not exceed exemption limit, agricultural income cannot be added)	Nil
Total Income	**1,40,000**

Tax Liability = Tax on Rs.1,40,000 is Nil.

Reader's Note:

Practical 20

Mr. Kartikey,31 years, resident, provides the following information.

Particulars	Rs.
Total Income	5,00,000
Agriculture Income	5,000

Compute his tax liability.

Solution

Computation of Total Income

Particulars	Rs.
Total Income	5,00,000
Add: Agricultural Income (since agriculture income does not exceed Rs.5,000, hence it cannot be added for rate purpose)	NIL
Total Income	**5,00,000**

Computation of Tax Liability

Particulars	Tax Rate	Rs.
Upto Rs.2,50,000	-	Nil
Rs.2,50,000 to Rs.5,00,000	5%	12,500
Tax on Total income		12,500
Less: Rebate u/s. 87A		(Nil)
Sub-Total		**12,500**
Add: Education cess @2%		250
Secondary and higher education cess @ 1%		125
Total tax liability		**12,875**
Total tax liability (Rounded off)		12,880

Reader's Note:

Practical 21

(A) Mr. X (40 years, resident) provides the following information. Compute his tax liability

Particulars	Rs.
Business income	1,50,000
Long Term Capital Gain	1,80,000

(B) Suppose in the **Point (A)** Mrs. X also earned agriculture income of Rs.10,00,000. Find out tax liability.

Solution

(A) **Computation of Total Income**

Particulars	Rs.
Income under the head "PGBP"	
Business Income	1,50,000
Income under the head "Capital Gain"	
Long Term Capital Gain	1,80,000
Gross Total Income	**3,30,000**
Less: Deduction under chapter VI –A	Nil
Total Income	**3,30,000**

Computation of Tax Liability

TI= Rs. 3,30,000

Long Term Capital Gain

LTCG	Rs.1,80,000
Less: Shifting Benefit	(Rs.1,00,000)
Taxable LTCG @20%	Rs.80,000

Tax on LTCG =1,00,000 x 20% =16,000

Balance Income

Balance Income	Rs.1,50,000
Add: Shifting Benefit	Rs.1,00,000
Income subject to Slab Rate	Rs.2,50,000

Tax on Balance Income = Nil

Tax	Rs.16,000
Less: Rebate u/s 87A **(Refer Note 2)**	(Rs.2,500)
	Rs.13,500
Add: 3% Edu cess	Rs.405
Tax Payable	**Rs.13,905**
Tax Payable (Rounded off)	**Rs.13,910**

(B)

Computation of Tax Liability

Particulars	LTCG Income (Rs.)	Balance Income (Rs.)	Total (Rs.)
Total Income	1,80,000	1,50,000	**3,30,000**
Shifting Benefit	(1,00,000)	1,00,000	-
Balance	**80,000**	**2,50,000**	**3,30,000**
Add: Agricultural Income		10,00,000	10,00,000
Total Income (including Agricultural Income)	**80,000**	**12,50,000**	**13,30,000**
Tax Rate	**20%**	**Slab Rate**	
Tax	**16,000**	**1,87,500**	**2,03,500**
Less: Rebate on Agricultural Income (Working Note)	-	1,87,500	1,87,500
Balance Tax	**16,000**	**Nil**	**16,000**
Less: Rebate on u/s 87A	(2,500)	-	(2,500)
Balance Tax	**13,500**	**Nil**	**13,500**
Add: Education cess 3%			405
Tax Payable			**13,905**
Tax Payable (Rounded off)			**13,910**

Working Note:- Rebate on Agricultural Income	
Basic Exemption Limit	Rs.2,50,000
Agricultural Income	Rs.10,00,000
Total	Rs.12,50,000
Tax on Rs.12,50,000	Rs.1,87,500

Reader's Note:

Practical 22

Mr. X, resident, senior citizen provides the following information.

Particulars	Rs.
Business income	4,90,000
Long Term Capital Gain	5,00,000
Short Term Capital Gain	2,00,000
Winning from horse races	25,000
Agriculture income	20,00,000
Investment in PPF	50,000

Compute his tax liability.

Solution

Computation of Total Income

Particulars	Rs.
Income under the head "PGBP"	
— Business Income	4,90,000
Income under the head "Capital Gains"	
— Short Term Capital Gain	2,00,000
— Long Term Capital Gain	5,00,000
Income under the head "Income from other Sources"	
— Income from winning horse race	25,000
Gross Total Income	**12,15,000**
Less: Deduction u/s 80C- Investment in PPF	50,000
Total Income	**11,65,000**

Computation of Tax Liability

Particulars	LTCG	Income from Horse Race (Rs.)	Balance Income (Rs.)	Total (Rs.)
Total Income	5,00,000	25,000	6,40,000	**11,65,000**
Add: Agricultural Income			20,00,000	20,00,000
Total Income (including Agricultural Income)	**5,00,000**	**25,000**	**26,40,000**	**31,65,000**
Tax Rate	20%	30%	Slab Rate	
Tax	1,00,000	7,500	6,02,000	7,09,500
Less: Rebate on Agricultural Income (Working Note)		-	(5,00,000)	(5,00,000)
Balance	**1,00,000**	**7,500**	**1,02,000**	**2,09,500**
Add: Education cess 3%				**6,285**
Tax Payable				**2,15,785**
Tax Payable (Rounded off)				**2,15,790**

Working Note:- Rebate on Agricultural Income	
Basic Exemption Limit	Rs.3,00,000
Agricultural Income	Rs.20,00,000
Total	Rs.23,00,000
Tax on Rs. 23,00,000	Rs.5,00,000

Reader's Note: