FINAL COURSE

Practice Manual

PAPER : 7

DIRECT TAX LAWS

As amended by the Finance Act, 2016

Assessment Year 2017-18

[Relevant for May, 2017 and
November, 2017 examinations]

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This Practice Manual has been prepared by the faculty of the Board of Studies. The objective of the Practice Manual is to provide teaching material to the students to enable them to obtain knowledge and skills in the subject. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the Practice Manual has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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A WORD ABOUT PRACTICE MANUAL

The Board of Studies has been instrumental in imparting theoretical education for the students of Chartered Accountancy Course. The distinctive characteristic of the course i.e., distance education, has emphasized the need for bridging the gap between the students and the Institute and for this purpose, the Board of Studies has been providing a variety of educational inputs for the students. Bringing out a series of subject-wise Practice Manuals is one of the quality services provided by the Institute. These Practice Manuals are highly useful to the students preparing for the examinations, since they are able to get answers for all important questions relating to a subject at one place and that too, grouped chapter-wise. It covers a wide range of questions including practical questions and questions based on case laws. The Practice Manual includes questions from past examinations at Final level as well as other important questions, which would facilitate in thorough understanding of the provisions contained in the chapters of the Study Material.

Students are advised to read the Study Material [Edition: November, 2015 Reprint Edition: November, 2016] along with:

(1) The Supplementary Study Paper – 2016 explaining the amendments by the Finance Act, 2016 and the significant notifications and circulars issued between 1.5.2015 and 30.4.2016, relevant for May, 2017 and November, 2017 examinations; and

(2) The Select Cases in Direct and Indirect Tax Laws – 2016, wherein select significant Supreme Court and High Court decisions upto 30.4.2016 have been summarized and reported.

Both the Supplementary Study Paper – 2016 and Select Cases – 2016 have been divided into chapters in line with the Study Material to facilitate combined reading of related provisions.

The significant notifications and circulars issued after 30.04.2016 and significant case laws reported after 30.4.2016 but relevant for May 2017 and November 2017 examinations would be given in the Revision Test Paper (RTP) for the said examinations.

The Practice Manual on the subject of "Direct Tax Laws" is divided into 28 chapters in line with the Study Material, Supplementary Study Paper 2016 and Select Cases in Direct and Indirect Tax Laws - 2016. This will help the students correlate the Practice Manual with these publications and facilitate in complete revision of each chapter. This Practice Manual has been prepared on the basis of the law as amended by the Finance Act, 2016 and would, therefore, be relevant for students appearing in May, 2017 and November, 2017 examinations.

The questions contained in the Practice Manual have been adapted and answered taking into account the amendments made by the Finance Act, 2016, which are relevant for A.Y. 2017-18, being the assessment year applicable for students appearing in May, 2017 and November, 2017 examinations.

The Practice Manual also contains a matrix showing the topic-wise distribution of examination questions to make the students aware of the weightage given to the various chapters in the examination. The Practice Manual will serve as a useful and handy reference guide while preparing for Final Examination. Further, it will enhance the understanding about the pattern of questions set and the manner of answering such questions. It will enable solving the problems in the best possible manner and guide the students to improve their performance in the examinations. It will also help them to work upon their grey areas and plan a strategy to tackle problems in direct taxes. For further clarification/guidance, students may send their queries at priya@icai.in or aparna.chauhan@icai.in.

Happy Reading and Best Wishes!

Paper – 7: Direct Tax Laws

Statement showing topic-wise distribution of Examination Questions along with Marks

	Chapter	Nov-11		May-12		Nov-12		May-13		Nov-13		May-14		Nov-14		May-15		Nov-15		May-16		Total Marks	Avg. Marks
		Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M		
1	Basic Concepts			6(d)	**3**			7(a)	**6**	2(b) 3(a)(i) 4(i)	**5** **2** **4**											**20**	**2**
2	Residence and scope of Total Income	3(c)	**4**			6(c)	**4**			6(c)	**7**			3(b)	**4**							**19**	**1.9**
3	Incomes which do not form part of Total Income	1(a)	**10**	1(a) 3(a)	**10** **6**	4(b) 5(a)	**4** **4**			3(a)(ii)	**2**			2(c)	**4**	3(a)	**8**	3(a)(ii)	**2**			**50**	**5**
4	Income from Salaries					4(e)	**4**															**4**	**0.4**
5	Income from house property															4(a)	**4**					**4**	**0.4**
6	Profits and Gains of Business and Profession	3(a) 4(b) 4(c)	**7** **4** **4**			1(b) 3(c)(i) 4(a) 4(d)	**4** **2** **4** **4**	2 5(a) 5(b) 5(d) 5(e)	**16** **4** **4** **4** **4**	1(a) 4(iii) 5(a) 7(b)	**7** **4** **12** **10**	4(a) 6(a) 6(b)	**4** **8** **8**	2(a) 2(b) 4(a) 6(a)	**4** **4** **8** **9**			3(d) 4(c)	**6** **4**	4(a) 4(b) 5(c)	**4** **4** **3**	**160**	**16**
7	Capital gains			3(b) 6(a) 6(c)	**5** **3** **7**	1(a)	**6**	1(a) 3(a)	**10** **6**	4(v)	**4**	4(b)	**4**	5(a)	**10**	4(b) 5(a)	**4** **7**	1(b)	**10**			**76**	**7.6**

8	Income from Other Sources	3(b)	**5**	4(e) 7(c)	**4 7**	5(b)	**4**	3(b)	**4**	2(a)	**5**	7(c)	**4**	3(d)	**4**	4(c)	**4**	4(b)	**4**	3(c)	**4**	**49**	**4.9**
9	Income of other persons included in Assessee's total Income							7(b)	**4**					3(a)	**4**	7(b)	**4**	6(c)	**6**	6(c) 7(a)	**2 6**	**26**	**2.6**
10	Set-Off and Carry Forward of losses			6(b)	**3**																	**3**	**0.3**
11	Deductions from Gross Total Income	7(a)	**5**			3(c) (ii) 6(d)	**3 3**	7(c)	**6**							1(b)	**8**			3(a)	**6**	**31**	**3.1**
12	Inter-Relationship between Accounting and Taxation	7(c)	**6**			4(c)	**4**															**10**	**1**
13	Assessment of Various entities	2 4(e) 5(b)	**16 4 6**	2	**16**	2 3(b)	**16 6**	4(b)	**8**	3(a)(ii) 3(c) 4(iv)	**2 4 4**	1(a) 2 3(b)	**10 16 8**	1(a)	**15**	1(a) 2 4(d)	**10 16 4**	1(a) 2 4(d) 5(b)	**10 16 4 6**	1(a) 2 5(a) (ii)	**10 16 3**	**226**	**22.6**
14	Tax Planning and Ethics in taxation															5(b)	**5**					**5**	**0.5**
15	Double Taxation Relief	5(a)	**4**	5(d)	**4**			6(a)	**8**			7(a)	**8**	3(c)	**4**			6(a)	**7**	5(a) (i) 5(b) (i) 7(d)	**3 2 4**	**44**	**4.4**
16	Transfer Pricing	5(c)	**6**	5(a)	**4**	6(b)	**4**	3(c)	**6**			3(a)	**8**					5(c)	**6**			**34**	**3.4**
17	Foreign Collaboration					5(c)	**8**															**8**	**0.8**
18	Business Restructuring																			1(b)	**10**	**10**	**1**

19	Taxation of E-commerce Transactions			5(b)	**4**																	**4**	**0.4**
20	Income-Tax Authorities	4(a) 6(a)	**4** **4**							2(c) 3(b)(i) 6(b)	**6** **3** **4**			5(b)	**3**			4(e) 6(b)	**4** **3**	3(b)	**4**	**35**	**3.5**
21	Assessment procedure	6(b) 6(c)	**4** **5**	4(c) 4(d) 7(b)	**4** **4** **4**	3(a)	**5**	5(c) 6(b)(i) 6(b)(ii)	**4** **2** **2**			5(a)	**8**	5(c) 7(b) 7(c)	**3** **4** **6**			3(a)(i) 5(a)	**2** **4**	6(a) 5(b)(ii)	**4** **2**	**67**	**6.7**
22	Settlement of Tax cases			3(c)	**5**							4(d)	**4**			5(c)	**4**	7(d)	**3**	6(b)	**4**	**20**	**2**
23	Advance Rulings			5(c)	**4**					3(b)(ii)	**3**					6(a)	**4**					**11**	**1.1**
24	Appeals and Revisions	6(d)	**3**					6(c)	**4**	5(b)	**4**	5(b)	**8**	2(d) 7(a)	**4** **6**	6(b) 6(c)	**4** **8**	4(a) 7(a)	**4** **3**			**48**	**4.8**
25	Penalties					6(a) 7(b)	**5** **5**			4(ii) 6(a)	**4** **5**					4(e)	**4**	3(c)	**4**	4(d)	**4**	**31**	**3.1**
26	Offences and Prosecution																	3(b)	**2**			**2**	**0.2**
27	Miscellaneous provisions									1(b)	**3**											**3**	**0.3**
28	Collection and Recovery of Tax	4(d) 7(b)	**4** **5**	4(a) 4(b) 7(a)	**4** **4** **5**	7(c)	**7**	4(a)	**8**	7(a)	**6**	4(b) 4(e) 7(b)	**4** **4** **4**	4(b)	**8**	7(a) 7(c) 7(d)	**4** **4** **4**	7(b) 7(c)	**6** **4**	3(d) 4(c) 4(e) 5(d) 7(b) 7(c)	**2** **4** **4** **3** **4** **8**	**110**	**11**

Note:' Q' represents question numbers as they appeared in the question paper of respective examination. 'M' represents the marks which each question carried in that examination. The question papers of all the past attempts of Final Examination can be accessed from the BOS Knowledge Portal on the Institute website www.icai.org.

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1

Basic Concepts

Question 1

MNO Limited is engaged in manufacturing activities. It received liquidated damages of ₹ 10 lakh from supplier of machinery due to delay in supply of machinery. State, with reasons, whether or not the income by way of liquidated damages is a revenue receipt subject to income-tax.

Answer

The issue under consideration in this case is whether the liquidated damages received by a company from the supplier of machinery for delay in supply of machinery is revenue in nature.

On this issue, the Apex Court, in the case of *CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422*, held that such liquidated damages were directly and intimately linked with the procurement of a capital asset which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee.

Applying the rationale of the above Apex Court ruling in this case, the income by way of liquidated damages of ₹ 10 lakh received by MNO Ltd. from the supplier of machinery is a capital receipt.

Question 2

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

Answer

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

Question 3

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

Answer

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

Question 4

MKG Agency is a partnership firm consisting of father and three major sons. The partnership deed provided that after the death of father, the business shall be continued by the sons, subject to the condition that the firm shall pay 20% of the profits to the mother. Father died in March, 2016. In the previous year 2016-17, the reconstituted firm paid ₹ 1 lakh (equivalent to 20% of the profits) to the mother and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm.

Answer

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

Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount but it so received for and on behalf of the mother, who possesses the overriding title.

Therefore, the amount paid to the mother should be excluded from the income of the firm. This view has been confirmed in *CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom).*

Question 5

What meaning has been assigned to "India" under the Income-tax Act, 1961?

Answer

Section 2(25A) defines the term "India" to mean the territory of India as referred to in Article 1 of the Constitution, its territorial waters, seabed and sub-soil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 and the air space above its territory and territorial waters.

Question 6

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

Answer

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

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

Therefore, the HUF would retain its status as such.

Question 7

What is a zero coupon bond? State briefly the treatment of zero coupon bonds in the hands of the issuer and the investor under the Income-tax Act, 1961.

Answer

Section 2(48) of the Income-tax Act, 1961 defines zero coupon bond. It means a bond issued by any infrastructure capital company or infrastructure capital fund or a public sector company or scheduled bank on or after 1.6.2005, in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and which the Central Government may specify by way of notification in the Official Gazette.

Discount, which is the difference between the amount received or receivable by the issuer on issue of the zero coupon bond and the amount payable by the issuer on maturity or redemption thereof, would be allowed as deduction in the hands of the issuer on a pro rata basis having regard to the period of life of the bond as provided in section 36(1)(iiia). In other words, the discount on issue of zero coupon bonds is to be deducted pro-rata during the period of life of such bond. No tax is required to be deducted at source under section 194A in respect of income paid or payable in relation to such bond.

Maturity or redemption of a zero coupon bond will be treated as a transfer for purposes of capital gains in the hands of the investor as provided in section 2(47)(iva). Zero coupon bond held for not more than 12 months will be treated as a short-term capital asset. Thus, a zero coupon bond held for more than 12 months will be treated as a long-term capital asset. The proviso to section 112(1) will be applicable to long-term capital gain arising from the transfer of zero coupon bonds. Consequently, where the tax payable in respect of long-term capital gain arising from the transfer of zero coupon bonds exceeds 10% of the amount of capital gains computed without indexation, then, such excess shall be ignored while computing the tax payable by the investor.

Question 8

Mr. C borrowed on Hundi, a sum of ₹ 25,000 by way of bearer cheque on 11-09-2016 and repaid the same with interest amounting to ₹ 30,000 by account payee cheque on 12-10-2016.

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

Answer

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

In this case, Mr. C has borrowed ₹ 25,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Mr. C for the previous year 2016-17. Since the repayment of the same along with interest was made by way of account payee cheque, the same would not be hit by the provisions of section 69D. Therefore, the action of the Assessing Officer treating the amount borrowed as income during the previous year is valid in law.

Exercise

1. *Define the following terms under the Income-tax Act, 1961 -*

   (i) Assessee; (ii) Person; (iii) Previous year

2. *Write short notes on the following -*

   (i) Year of accrual of dividend; (ii) Marginal relief

3. *"Income of a previous year will be charged to tax in the assessment year following the previous year"- Discuss the exceptions to this general rule.*
4. *In certain cases, unexplained cash credit, unexplained investment, unexplained money or unexplained jewellery etc. is detected by the Assessing Officer. What is the previous year for charging such income to tax? Explain.*
5. *Can expenditure incurred to earn dividend income (from both Indian companies and foreign companies) be claimed as deduction? Discuss.*
6. *The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to ₹ 60,000, which was not debited in the books of account for the year ending 31.3.2017. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of ₹ 60,000 in the hands of the firm for the assessment year 2017-18. The firm claims that even if the addition is made, the sum of ₹ 60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.*

Answers

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

2

Residence and Scope of Total Income

Question 1

Peeyush, returned to India on 12th June, 2016 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various income and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2017-18:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2016.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. in foreign currency (not received in India) and of ₹ 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ₹ 37,500 while in terms of Indian Rupee it was ₹ 50,000.

Answer

Peeyush returned to India on 12th June 2016 for permanently residing in India after staying in UK for 20 years. During the P.Y.2016-17, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2016-17, he would be a resident in India for the A.Y.2017-18. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2016-17 / his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2017-18 is, therefore, **Resident But Not Ordinarily Resident.**

As per section 5(1), only income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹ 1,500 per child under section 10(32).

Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹ 1,500. Therefore, ₹18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2017-18 since it is not the income of the P.Y.2016-17.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2017-18. Since his total income(i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2017-18.

Question 2

Arjun who works as a Finance Controller of ABC Ltd. was deputed to work at the company's office in U.K. on 26.09.2016 for a period of 2 years. He claims that he is a non-resident for the A.Y.2017-18. Is his claim valid? Discuss.

Answer

As per section 6, an individual is treated as resident if he has stayed for 182 days in India during the previous year or if he has stayed for 60 days in the current previous year and 365 days in total during the four preceding previous years. However, where an Indian citizen leaves India for the purpose of employment, he will be resident if he stayed for 182 days instead of 60 days during the previous year.

In the given case, Arjun is employed in India and he was deputed to work at the company's branch office in U.K. on 26.09.2016 for a period of 2 years. Since, Arjun leaves India for the purpose of employment, the condition of 182 days in the current previous year would only be applicable for treating him as resident. However, during the P.Y. 2016-17, he stayed in India for 179 days. Hence, his claim that he is non-resident for the A.Y. 2017-18, is valid.

Question 3

Poulomi, a chartered accountant, is presently working in a firm in India. She has received an offer for the post of Chief Financial Officer from a company at Singapore. As per the offer letter, she should join the company at any time between 1st September, 2016 and 31st October, 2016. She approaches you for your advice on the following issues to mitigate her tax liability in India:

(i) Date by which she should leave India to join the company;

(ii) Direct credit of part of her salary to her bank account in Kolkata maintained jointly with her mother to meet requirement of her family

(iii) Period for which she should stay in India when she comes on leave.

Answer

The following category of individuals will be treated as resident in India only if the period of their stay in India during the relevant previous year is 182 days or more :-

(a) Indian citizens, who leave India in any previous year, *inter alia*, for purposes of employment outside India, or

(b) Indian citizen or person of Indian origin engaged outside India, *inter alia*, in an employment, who comes on a visit to India in any previous year.

(i) Since Poulomi is leaving India for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, Poulomi should leave India on or before 28th September, 2016, in which case, her stay in India during the previous year would be less than 182 days and she would become non-resident for the purpose of taxability in India. In such a case, only the income which accrues or arises in India or which is deemed to accrue or arise in India or received or deemed to be received in India shall be taxable.

The income earned by her in Singapore would not be chargeable to tax in India for A.Y. 2017-18, if she leaves India on or before 28th September, 2015.

(ii) If any part of Poulomi's salary will be credited directly to her bank account in Kolkata then, that part of her salary would be considered as income received in India during the previous year under section 5 and would be chargeable to tax under Income-tax Act, 1961, even if she is a non-resident. Therefore, Poulomi should receive her entire salary in Singapore and then remit the required amount to her bank account in Kolkata in which case, the salary earned by her in Singapore would not be subject to tax in India.

(iii) In case Poulomi visits India after taking up employment outside India, she would be covered in the exception provided in (b) above and she will be treated as resident only if the period of her stay during the relevant previous year amounts to 182 days or more.

Therefore, when Poulomi comes India on leave, she should stay in India for less than 182 days during the relevant previous year so that her status remains as a non-resident for the relevant previous year. Moreover, she should not visit India again during the current previous year i.e. P.Y. 2016-17.

Question 4

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2017 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2017-18. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2017-18.

Answer

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y.2017-18.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

Question 5

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2017 in the following case shall be subject to tax in the A.Y. 2017-18:

Mr. Ravi, an IAS Officer, was posted to USA by the Government of India on 11.07.16 for a period of three years. He was paid salary of ₹ 3 lacs for the period 01.04.16 to 10.07.16 and of ₹ 12 lacs for the period upto 31.03.17. He left India for USA in the night of 10.07.16 and did not come even for a day up till 31.03.2017.

Answer

The salary drawn by an IAS Officer by virtue of his posting in USA, despite the fact that he was a non-resident in the previous year, shall be subject to tax in India as per section 9(1)(iii) which states that income chargeable under the head "Salaries" payable by the Government to a citizen of India for his services outside India shall be deemed to accrue or arise in India. Therefore, the total amount of salary of ₹ 15 lakh received by the IAS Officer in and outside India shall be subject to tax in India in the A.Y 2017-18.

Question 6

JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of ₹ 1 crore and ₹ 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of ₹ 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.

Answer

The *Explanation* below section 9(2) clarifies that income by way of, *inter alia*, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per section 9(2), the fee of ₹ 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of ₹ 1 crore (as it is for rendering services outside India) is not correct.

Question 7

State with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:

(i) *A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.*

(ii) *A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.*

(iii) *Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.*

(iv) *Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2016, with an Indian Company and was in receipt of interest on 8% debentures for ₹ 20 lakhs, issued by Indian Company, in consideration of providing technical know-how during previous year 2016-17.*

Answer

(i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii) *[Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)].*

As per *Explanation* to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the Supreme Court in *Barendra Prasad Roy v. ITO (1981) 129 ITR 295.*

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, *inter alia*, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India.

(iv) ₹ 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Note – *Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.*

Question 8

Liaison Office maintained in India to explore the opportunity of business in India does not constitute business connection.

Answer

The statement is correct.

If a Liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.

In this case, the Liaison Office is maintained for the purpose of exploring the opportunity of business in India, which is in the nature of preparatory or auxiliary activity. It is assumed that such activities are approved by the Reserve Bank of India.

Since it does not undertake any commercial, trading or industrial activity, directly or indirectly, the Liaison Office does not constitute a business connection in this case.

Exercise

1. *During the previous year 2016-17, Abhinav had the following income:*

		₹
(a)	*Salary income received in India for services rendered in Nepal*	*15,000*
(b)	*Income from profession in India, but received in France*	*10,000*
(c)	*Property income in Belgium (out of which ₹ 6,000 were remitted to India)*	*9,000*
(d)	*Profits earned from business in Hyderabad*	*8,000*
(e)	*Profits from a business carried on at Nepal but controlled from India*	*25,000*
(f)	*Past untaxed profits remitted to India during the previous year 2016-17*	*75,000*

Compute his income for assessment year 2016-17 if he is (i) resident and ordinarily resident, (ii) Not ordinarily resident, and (iii) Non-resident in India.

2. *Mr. Aakash earns the following income during the previous year 2016-17. Compute his total income for A.Y.2017-18 if he is (i) resident and ordinarily resident; (ii) resident but not ordinarily resident; (iii) non-resident.*

	Particulars	**₹**
(a)	*Profits from a business in Ranchi managed from Canada*	*23,000*
(b)	*Income from property in Canada received there*	*36,000*
(c)	*Income from agricultural land in Nepal received there and remitted to India later on.*	*33,500*
(d)	*Interest on debentures in an Indian company received in Canada*	*6,200*
(e)	*Income from profession in Canada which was set up in Patna, received there.*	*42,000*
(f)	*Profits earned from business in Canada which is controlled from Jamshedpur, 25% of the profits being received in Jamshedpur*	*80,000*
(g)	*Fees for technical services rendered in Patna but received in Canada*	*25,000*
(h)	*Untaxed foreign income of earlier years brought to India*	*15,500*
(i)	*Dividend from a Canadian company received in Canada*	*14,000*
(j)	*Interest on development bonds issued in Canada, 40% of interest received in Patna*	*20,000*

3. *Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2016. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who left India one week before Mr. A's departure, to the extent of ₹ 10 lakhs and buys shares in X Ltd., an Indian*

company. Discuss the taxability of the interest charged @10% in B's hands where the same has been received in New York.

Answers

1. (i) ₹ 67,000; (ii) ₹ 58,000; (iii) ₹ 33,000.

2. (i) ₹ 2,79,700; (ii) ₹ 1,84,200; (iii) ₹ 82,200.

3. An individual is said to be resident in India in any previous year, if he -

(i) has been in India during that year for a total period of 182 days or more, or

(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In this case, A has been in India only from 1.4.2016 to 30.04.2016 i.e. for 30 days. Therefore, he does not satisfy either of the conditions in (i) or (ii) and is, hence, a non-resident. B, who left India one week before A's departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by A on money borrowed from B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of B.

3

Income which do not form part of Total Income

Question 1

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?

Answer

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. Therefore, from a plain reading of section 14A, it is apparent that the intention of the section is to disallow expenditure in relation to income which does not form part of total income i.e., expenditure in relation to income exempt under section 10 to 13B.

Therefore, the provisions of section 14A cannot be applied for disallowing expenditure relating to income for which deduction is available under Chapter VIA.

Question 2

If an assessee does not claim any expenditure with respect to exempt income then write down the prescribed methods that the Assessing Officer would follow to determine the amount of expenditure incurred in relation to exempt income.

Answer

If the assessee claims that no expenditure has been incurred by him in relation to exempt income, the Assessing Officer shall proceed to determine the amount of expenditure incurred in relation to such exempt income in accordance with the method prescribed in 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.

Question 3

Mr. W has provided the following information regarding his income and expenditure of the previous year 2016-17.

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 ₹ 50,00,000.

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

Answer

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, since the Assessing Officer is not satisfied with the correctness of claim of Mr. W, he shall determine the amount of expenditure in relation to exempt income in the manner provided in Rule 8D.

Dividend income of ₹ 1,25,000 from mutual fund is exempt under section 10(35). Therefore, dividend income represents exempt income of Mr. W.

	Particulars	₹
(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. 2017-18

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

Note - *Since it has been stated in the question that Mr. W claims that no expenditure was incurred by him for exempt income earned, it is logical to assume that the consultation charges of ₹ 15,000 and the entire interest expenses of ₹ 2,25,000 has been deducted to arrive at the income from business of ₹ 5,00,000. Therefore, the amount of expenses in relation to exempt income has been added back to compute the resultant total income.*

Question 4

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

Answer

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

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

Question 5

State with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the assessment year 2017-18:

(1) Rent of ₹ 60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes.

(2) Mr. Ganesh, a Central Government employee, was in receipt besides basic salary of ₹ 25,000 p.m., an amount of ₹ 2,000 p.m. as entertainment allowance.

Answer

(1) As per section 10(1), agricultural income is exempt from tax. The meaning and scope of agricultural income is defined in section 2(1A). According to *Explanation 2* to section 2(1A), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. It appears in this case that the house was occupied by tenants for residential purposes. Therefore, the rent of ₹ 60,000 from letting out of houses constructed on agricultural land for residential purposes shall not be treated as agricultural income by virtue of *Explanation 2* to section 2(1A). Hence, such income would be chargeable to tax.

(2) The entertainment allowance received by the Mr. Ganesh is taxable under the head "Salaries". However, deduction under section 16(ii) is allowable to the extent of least of the following, since Mr. Ganesh is a Central Government employee.

(i) $1/5^{th}$ of the salary $\times \frac{1}{5} \times 25{,}000 \times 12 = 60{,}000$

(ii) ₹ 5,000

(iii) Actual entertainment allowance received, i.e., ₹ 24,000 in this case.

Least of above ₹ 5,000, which is allowable as deduction under Section 16(iii).

Question 6

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2017 in each of the following cases shall be subject to tax in the A.Y. 2017-18:

(i) Income of ₹ 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land.

(ii) Mr. Gaitonde, born and brought up in the State of Sikkim, had a net profit of ₹ 2,25,000 from the business located in Sikkim and interest of ₹ 55,000 on the securities/ bonds issued by the Government of Rajasthan.

Answer

(i) *Explanation 3* to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income, whether or not the basic operations were carried out on land. Accordingly, the income of ₹ 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under section 10(1).

(ii) Section 10(26AAA) exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.

Question 7

An amount of ₹ 5 lacs was paid on 17.3.2017 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. 2017-18?

Answer

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

If, for this reason, any compensation is paid by the Central Government or by a State Government or by a local authority, then the same will be exempt from tax. Accordingly, the amount of ₹ 5 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).

Question 8

(a) A public sector company has engaged you to frame a scheme of voluntary separation for its employees so that the amount received by the employees under the scheme would qualify for tax exemption under section 10(10C). What points would you bear in mind while drawing up the scheme? What will be the tax treatment of the payments under the scheme in the hands of the company?

(b) Mr. Ramanand, after putting 25 years of service, opted for voluntary retirement and under approved scheme received an amount of ₹ 20 lacs as VRS compensation on 01.01.2017. He was advised by his tax consultant to claim exemption to the extent as specified in section 10(10C) and also the relief under section 89. He, in order to have an expert opinion, consults you and asks whether such a treatment of VRS compensation is permissible under the Act.

Answer

(a) Section 10(10C) provides that any amount received or receivable by an employee of a public sector company at the time of his voluntary retirement or termination of service under a scheme of voluntary separation is exempt to the extent such amount does not exceed ₹ 5,00,000. The scheme, however, should be framed in accordance with the guidelines prescribed under Rule 2BA.

The guidelines in Rule 2BA provide that the scheme of voluntary separation framed by a public sector company should be in accordance with the following requirements in order to be eligible for exemption –

(i) The scheme should apply to all employees (by whatever name called) including workers and executives of the company except directors.

(ii) The scheme should result in overall reduction in the existing strength of the employees of the company.

(iii) The vacancies caused by voluntary separation, should not be filled up.

(iv) The retiring employee should not be employed in another company or concern belonging to the same management.

(v) The amount receivable on voluntary separation should 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 of months' of service left before the date of retirement on superannuation.

Section 35DDA provides that, in the case of the company, where any expenditure has been incurred by way of payment to an employee under the scheme of voluntary retirement, one-fifth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year and the balance shall be deductible in equal installments in each of the four immediately succeeding previous years.

Note: *If exemption under section 10(10C) in respect of VRS compensation is opted by the taxpayer, he is not eligible for further relief under section 89.*

(b) Where any relief was allowed under section 89 for any assessment year in respect of any amount received or receivable on voluntary retirement, no exemption under section 10(10C) shall be allowed in respect of the said sum in that assessment year or any other assessment year.

Similarly, relief under section 89 cannot be claimed if benefit of exemption has been claimed under section 10(10C).

Mr. Ramanand can, therefore, opt to claim exemption of ₹ 5 lacs under section 10(10C) or relief under section 89(1) in respect of compensation received on voluntary retirement, but not both. Accordingly, the advice given by his tax consultant is not correct.

Question 9

Does the tax borne by employer on behalf of employee in respect of provision of non-monetary perquisites constitute an income in the hands of employee? What are the tax implications of such payment in the hands of employer?

Answer

Section 10(10CC) provides that in the case of an employee deriving income in the nature of non-monetary perquisites, the amount of tax on such income paid by the employer, is exempt from tax in the hands of the employee. In view of this, by virtue of exemption provided in section 10(10CC), the tax borne by the employer on behalf of employees in respect of provision of non-monetary perquisites is exempt in the hands of the employee.

As regards tax implications of such payment in the hands of employer, section 40(a)(v) provides for disallowance of the tax actually paid by employer under section 10(10CC) while computing the income chargeable under the head “Profit and gains of business or profession”.

Question 10

Mr. Divyam avails the benefit of LTC and went by air (economy class) on a holiday in India on 25.01.2017 along with his wife and three children consisting of son aged 4 years and twin daughters of 1 year age. Total cost of tickets reimbursed by his employer was ₹ 90,000 (₹ 60,000 for 2 adults and ₹ 30,000 for the three children). State with reasons the amount which can be claimed by Mr. Divyam out of the reimbursement as not subject to tax. Will your answer be different where among his three children the twins were of 4 years of age and the age of the son was of 1 year?

Answer

Mr. Divyam can avail exemption as per section 10(5) on the entire amount of ₹ 90,000 reimbursed by the employer for the LTC as the same was availed for himself, his wife and the three children in India and the journey was also undertaken by economy class airfare. The restriction imposed for two children is not applicable to the multiple births which take place after the first child.

However, if the age of the twin daughters is more than the age of the son, the restriction imposed for two children under the section would be applicable and therefore, Mr. Divyam cannot avail exemption in this case for all the three children. The exemption of LTC can be availed in respect of only two children. Therefore, the fare of ₹ 10,000 (i.e., ₹ 30,000 × 1/3) reimbursed for one child will form part of taxable salary and balance amount of LTC of ₹ 80,000 (₹ 90,000 - ₹ 10,000) will be exempt under section 10(5).

Question 11

An educational institution having annual receipts of ₹ 1.20 crore during the P.Y. 2016-17, has to make an application to the prescribed authority before 31.3.2017 for claiming tax exemption under section 10(23C). Discuss the correctness or otherwise of this statement.

Answer

This statement is not correct.

According to the first proviso to section 10(23C), an educational institution having aggregate of annual receipts greater than ₹ 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 ₹ 1.20 crore during the P.Y. 2016-17) 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 under section 10(23C)(vi) for previous year 2016-17.

Question 12

Ms. J, a Sikkimese woman, married Mr. K, a non-Sikkimese, on 1st January, 2008. During the previous year 2016-17, she received rent of ₹ 12 lacs from letting out of house properties situated in the State of Sikkim. Is she liable to income-tax for assessment year 2017-18? Will your answer be different, if she had married Mr. K on 16th April, 2008?

Answer

Section 10(26AAA) provides that the following income, which accrues or arises to a Sikkemese individual, shall be exempt from income-tax:

(1) Income from any source in the State of Sikkim; and

(2) Income by way of dividend or interest on securities.

However, the aforesaid exemption will not be available to a Sikkimese woman, who marries a non-Sikkemese individual on or after 1st April, 2008.

Since Ms. J, the assessee, married Mr. K on 1st January, 2008, income derived by her by way of rent from properties situated in the State of Sikkim shall be exempt under section 10(26AAA).

However, if she had married Mr. K on 16th April, 2008, the exemption would not be available.

Note: *The restriction in section 10(26AAA) applies only to Sikkimese women and not to men who are eligible for the exemption in respect of the above said incomes regardless of their marrying Sikkemese or non-Sikkemese women.*

Question 13

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 ₹ 5,00,000 in March, 2017, besides the family pension during the year of ₹ 2,40,000. She wants to know the taxability of both the receipts. Decide.

Answer

According to *CBDT Circular No.776 of June 8, 1999*, 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, ₹ 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.

Question 14

R purchased equity shares in P Ltd., a constituent of BSE-500 index on Mumbai Stock Exchange on 1st March, 2014. He sold the shares on 4th March, 2017 at a loss of ₹ 10,000. He wants to set off the loss against other long-term capital gain during the year. Examine whether such set off is permissible. Both purchase and sale transactions were entered into on a recognized stock exchange.

Answer

Section 10(38) exempts long term capital gain arising from transfer of equity shares in a company or a unit of an equity oriented fund, if such transfer has been subjected to securities transaction tax. Hence, the capital gain / capital loss will have no tax implication.

In this case, the assessee has suffered a loss of ₹ 10,000 by selling eligible equity shares. It is settled principle that the loss arising from an exempt source is not eligible for set off against income arising from a taxable source. In the case of *CIT v. Thiagarajan. S.S (1981) 129 ITR 115 (Mad),* the Madras High Court held that loss incurred by an assessee from an exempted source, cannot go to set off income from a taxable source. In view of the same, the set off in the instant case is not permissible.

Question 15

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, 2017:

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

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

₹ 100 lacs were realized out of export sales in time and balance of ₹ 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 2017-18.

Answer

Computation of total income of Siddarth Ltd. for A.Y.2017-18

Particulars	**₹**	**₹**
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	28,36,000
Unit Y (See Note 4)		36,54,000
Total Income		**64,90,000**

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

$$= \text{Profits of the business of the undertaking, being the Unit in SEZ} \times \frac{\text{Export turnover of the undertaking (in respect of computer software)}}{\text{Total turnover of the business of the undertaking}}$$

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

$$= ₹\ 63,81,000 \times \frac{1,00,00,000}{1,80,00,000}$$

$$= ₹\ 35,45,000$$

Notes:

(1) Deduction under section 10AA is available in respect of units established in Special Economic Zones which begin to manufacture or produce articles or things or provide any services during the previous year relevant to A.Y.2006-07 or thereafter. Under section 10AA(1), 100% of the profits and gains derived from export of such articles or things or from services is allowable as deduction for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be. Therefore, in this case, the profits from Unit X, located in a SEZ, will be eligible for deduction of 100% of the profits and gains derived from export, since P.Y.2016-17 is the second year of its operations. It is assumed that Unit X has fulfilled all the specified conditions for claim of deduction. 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 ₹ 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) = ₹ 1,20,00,000 – ₹ 20,00,000 = ₹ 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**	**Unit Y**	**Total**
	(₹)	**(₹)**	**(₹)**
Profit earned [after claim of bad debts under section 36(1)(vii) in Unit X]	63,00,000	36,00,000	99,00,000
Add: Depreciation calculated on SLM basis and charged in the proportion of sales (3:2)	5,40,000	3,60,000	9,00,000
	68,40,000	39,60,000	1,08,00,000
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	7,65,000
Profits of the business	**63,81,000**	**36,54,000**	**1,00,35,000**

(5) Depreciation as per the Income-tax Rules, 1962 for the A.Y.2017-18 has to be calculated as follows –

Particulars	₹
Actual cost of plant and machinery (₹ 9,00,000 / 15%)	60,00,000
Less: Depreciation @15% for P.Y.2015-16 (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 1.4.2016	51,00,000
Depreciation @15% on WDV for P.Y.2016-17 (₹ 51,00,000 × 15%)	**7,65,000**

Question 16

(a) ***"Save Wild Life"*** *an institution having its main object as 'preservation of wildlife', used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2017. The institution seeks your opinion to know whether such utilization of its income be treated for "charitable purpose"? Would your answer be different, if the main object of the institution is "advancement of object of general public utility"?*

(b) *A charitable trust derives its income from the business of providing mineral water to various companies situated in software technology park in Hyderabad. A sum of ₹ 30 lacs has been derived as net income from such business activity, which has been applied for the object of general public utility. The total receipts of the trust during the P.Y. 2016-17 was ₹ 140 lacs. Examine the taxability of application of the income, if the income so derived relates to the previous year 2015-16. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school's activity?*

Answer

(a) Section 2(15) defines "charitable purpose" to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of "charitable purpose" under section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the "advancement of any other object of general public utility". Such institution would continue to retain its "charitable" status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as "advancement of any other object of general public utility", derives income from an activity in the nature of trade during a financial year, it would lose its "charitable" status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its "charitable" status, even its main object is "advancement of any other object of general public utility", if such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(b) In the first case, net income from the business of supplying mineral water to various companies i.e., ₹ 30 lacs is not eligible for exemption under section 11, since the receipt from such activity exceeds 20% of total receipts (i.e., 20% of ₹ 140 lakhs) during the year. This is because "advancement of any object of general public utility" would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business, for example, supply of mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility.

On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the fourth limb of the definition of "charitable purpose" i.e. advancement of object of general public utility. It does not affect the other limbs of the definition viz. "relief of the poor", "education", "medical relief" etc.

Section 11(4) clarifies that "property held under trust" includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in the second case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

Question 17

Hundi (charitable box) superscribing "contributions in this hundi form part of corpus of trust fund" kept at Lord Venkateshwara Temple, Tirumala, was opened on 30.3.2017. Cash of ₹ 100 lacs and valuable articles worth ₹ 250 lacs were found to have been contributed by the devotees.

Answer

As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. In the given case, there is a specific declaration by the temple authorities that the contributions being put in the hundi (charity box) would form part of the corpus of the trust fund. Therefore, it is possible to take a view that those who put the contributions in the hundi give a tacit declaration that the contributions would form part of the corpus. Hence, a view can be taken that such contributions shall not be included in the total income of the recipient trust.

Further, it may be noted that the provision relating to taxability of anonymous donations under section 115BBC does not apply to voluntary contributions received by a trust or institution created or established wholly for religious purposes.

Question 18

A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:

(i) Rural reconstruction and upliftment of the masses through Cottage Industry.

(ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others.

Answer

Section 2(15) defines “charitable purpose” to include relief of the poor, education, medical relief, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, “advancement of any other object of general public utility” would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

“Advancement of any other object of general public utility” would continue to be a “charitable purpose”, if the total receipt from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust in the previous year, and such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(i) The Supreme Court has, in *Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010,* observed that “cottage industry” is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(ii) The welfare of industrial workers with a stipulation that the workers of settler of trust have preference over others would also constitute “charitable purpose” within the meaning of section 2(15). The Patna High Court has, *in CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764*, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

(1) the trust is created for a charitable purpose; and

(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because "relative" means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settler of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

Question 19

MSO Foundation, a charitable institution set up on 1st April, 2016 and registered under section 12AA with effect from that date, is engaged in providing education in hotel management. The organisation acquires a building for using the same for holding classes and office activities. It has approached you for your opinion on its eligibility to claim the cost of the building and also depreciation thereon in the current year and the subsequent year. Advise the institution indicating the reasons.

Answer

(i) 15% of income from property held for charitable purposes is exempt from tax under section 11. The remaining 85% of such "income" would be exempt if it is "applied" for charitable purposes in India.

(ii) Application of the amount can be for revenue or capital purposes. As long as the expenditure is incurred out of income earned by the trust and for the purposes of carrying on the objects of the trust, it would be treated as application of income even if such expenditure is for capital purposes. Therefore, since the building is acquired by the organization for holding classes and office activities, which is for the purposes of carrying on the objects of the charitable institution i.e., for providing education in hotel management, the cost of the building would be treated as application of income.

However, section 11 provides that where the cost of building is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

Question 20

A charitable institution registered under section 12A of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under Section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case?

Answer

Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, by notice in writing given to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any objects in particular for which the unspent income was sought to be accumulated or set apart. In *Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del.)*, it was held that it is not necessary for a charitable trust to particularise each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

Question 21

"Capital expenditure cannot be said to be application of income by a trust under section 11(1)(a) of the Income-tax Act, 1961." Examine the validity of this statement.

Answer

This statement is not valid, since, if the income is applied for the purchase of a capital asset for the purposes of the trust, it would still constitute application of income for charitable purpose. If an assessee invests in construction of a building so as to augment its resources for fulfilling the objectives of the institution, the same would be considered as application for charitable purpose. Similarly, repayment of loan taken for construction of a building or construction of a commercial complex so as to augment the resources of the trust would also amount to application of income for charitable purposes.

However, where the cost of such assets is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

Question 22

Can a trust created for charitable purposes in April 2014, having filed application for registration as per section 12A on 11.4.2016, claim benefits of sections 11 and 12 from Assessment Year 2015-16?

Answer

In respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e., the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year.

Therefore, since the trust has filed application for registration only on 11.4.2016, it cannot claim benefit of sections 11 and 12 from A.Y.2015-16. Assuming that the registration has been granted under section 12AA, the exemption would be available only from the A.Y. 2017-18, being the assessment year relevant to the previous year in which application is filed [i.e., P.Y. 2016-17].

However, where a trust has been granted registration under section 12AA in the P.Y. 2016-17, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust for assessment years 2015-16 and 2016-17, being the assessment years preceding the assessment year in which application is filed i.e., A.Y.2017-18, if assessment proceedings in respect of those years are pending before the Assessing Officer as on the date of such registration.

It may be noted that exemption in respect of earlier assessment years can be claimed only if the objects and activities of such trust or institution in the relevant earlier assessment years are the same as those on the basis of which such registration has been granted.

Question 23

Bharat Charitable Trust created on 1.1.2015 applied for registration of trust under section 12A of the Income-tax Act, 1961 before the Commissioner of Income-tax on 1.7.2016.

(i) Explain with reasons the period for which the trust is eligible to get exemption under section 11 and 12 of the Income-tax Act, 1961.

(ii) Can the exemption under sections 11 and 12 for A.Y. 2017-18 be denied if the trust is holding investments in equity shares of a public sector company?

(iii) The Trust has also applied for granting exemption under section 80G of the Income-tax Act, 1961. However, the approval for the same has been rejected by the Commissioner of Income-tax under section 80G(5)(vi) of the Income-tax Act on 30.9.2016. The Trust seeks your advice on whether it can file an appeal against the said rejection before the higher authorities.

Answer

(i) As per section 12A, in respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply in relation to the income of the trust from the assessment year relevant to the financial year in which the application is made i.e., the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. However, where registration has been granted to the trust under section 12AA, then the benefit of sections 11 and 12 shall apply in respect of income of the trust for the earlier assessment years, if the assessment proceedings of such earlier assessment years are pending before the Assessing Officer on the date of registration. The objects and activities of such trust in the relevant earlier assessment years should be the same as those on the basis of which such registration has been granted.

Hence, Bharat Charitable Trust shall be eligible to get exemption under sections 11 and 12 with effect from the financial year in which the application is made i.e., P.Y.2016-17 onwards. If assessment proceedings are pending for assessment year 2015-16 and A.Y. 2016-17, the benefit of section 11 and 12 shall apply for such assessment years, provided the objects and activities of the trust remain unchanged.

(ii) A trust registered under section 12AA cannot be denied exemption for holding shares in a public sector company in view of section 13(1)(d)(iii), which provides for denial of exemption to a trust holding shares in a company, other than, *inter alia*, shares in a public sector company. Hence, the exemption under section 11 and 12 cannot be denied to the trust for holding investments in equity shares of a public sector company.

(iii) Section 253 provides that an appeal can be filed before the Appellate Tribunal against an order passed by the Principal Commissioner or Commissioner under section 80G(5)(vi) rejecting the application of such trusts for the purpose of recognition under section 80G. Therefore, the trust can file an appeal before Appellate Tribunal against the said rejection.

Question 24

Help All, a trust created on 1st January, 2017 for providing relief to the poor, applied for registration under section 12A on 1st March, 2017. On that date, its corpus fund comprised only of the initial contribution made by the trustees. The Commissioner denied registration solely on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.

Answer

The Karnataka High Court, in *DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219,* opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in a case where the registration is sought much later after formation of the trust.

The High Court further observed that the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. The assessee-trust had not also collected any donation for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, where application is made shortly after formation of the trust, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

Applying the rationale of the above ruling, the Commissioner cannot deny registration solely on the ground that the trust had not commenced any charitable activity in this case, since the trust has applied for registration under section 12A within two months after its formation and the corpus fund comprised only of contribution made by the trustees. The Commissioner has to take into consideration the objects of the trust as mentioned in the trust deed to satisfy itself about the genuineness of the trust.

Question 25

Ramji Charitable Trust, registered u/s 12AA and recognized u/s 80G of the Income-tax Act, 1961, was created for providing relief to disabled persons. It filed the return of income for the year ended 31/3/2017, declaring 'Nil' income. While completing the assessment, the Assessing Officer found that a large sum was donated to the corpus of another trust by the assessee i.e., Ramji Charitable Trust. The contention of the assessee was that such donation was made out of the permissible accumulation of income of past years upto 15% u/s 11(1)(a) of the Act.

The Assessing Officer added the donation so made and by invoking the Explanation *to section 11(2), computed the taxable income of the assessee. Discuss the validity of the action of the Assessing Officer, in this case.*

Answer

As per the provisions of section 11(1)(a), accumulation upto 15% is permitted and no additional conditions are attached with such accumulation. It is an absolute exemption.

However, as per section 11(2), accumulation in excess of 15% is also allowed but subject to certain conditions mentioned therein. The provisions of section 11(2) are also subject to provisions of section 11(3)(d), which mentions that the amount accumulated in excess of 15%

under section 11(2) cannot be donated to another trust. If it is so donated, it shall be deemed to be the income of the donor trust in the year of payment.

The provisions contained in section 11(3)(d), however, cannot be applied to the accumulations made under section 11(1)(a) i.e., accumulations upto 15%, in the absence of specific provisions in this regard.

It was so held by the Delhi High Court in *DIT (Exemption) v. Bagri Foundation (2012) 344 ITR 193.*

Explanation to section 11(2) merely provides that if donation is made out of past accumulations upto 15%, it cannot be treated as application of income for charitable purposes. This does not imply that such donations have to be added to compute total income, which is so in the case of donations out of accumulations in excess of 15% made under section 11(2).

Consequently, if the donations made by Ramji Charitable Trust to another charitable trust were out of past accumulations upto 15% under section 11(1)(a), the same would not be liable to be included in the total income.

The action of the Assessing Officer in invoking the *Explanation* to section 11(2), to add such donations while computing the total income of the trust is, therefore, not valid.

Question 26

Educare, a trust created with the objective of promoting primary education in rural areas, filed an application for registration under section 12A on 30th April, 2016. Since the application was not disposed of by the Commissioner on or before 31st October, 2016 as required under section 12AA(2), the trust contended that it was deemed to be registered as per the provisions of section 12AA(1). Examine the correctness of contention of the trust.

Answer

As per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), **shall** be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Supreme Court, in *CIT v. Society for Promotion of Education (2016) 382 ITR 6,* held that once an application under section 12AA was made and the same was not responded to within six months, the trust would be deemed as registered with effect from the date following the expiry of the six month period.

Applying the rationale of the above Supreme Court ruling in this case, the trust would be deemed as registered with effect from 1.11.2016. The contention that the trust is deemed to be registered, since its application for registration has not been disposed of within six months is, therefore, correct.

Note: *The benefit of exemption under section 11 and 12 would be available from the A.Y. 2017-18, being the assessment year relevant to the financial year in which such application is made.*

Question 27

A charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of ₹ 3,90,000 for the year ending 31.3.2017 and sale proceeds of a capital asset, held by it for less than 36 months, amounting to ₹ 9,60,000, purchased a building during the year ending 31.3.2017 for ₹ 13,50,000. The capital asset was sold during the year ending 31.3.2017. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Is the claim made by the charitable trust valid in law?

Answer

Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of ₹ 3,90,000 for the year ended 31.3.2017. It has also earned short term capital gain from sale of capital asset for ₹ 9,60,000. The trust had utilized the entire amount of ₹ 13,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court in *S.RM. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636* ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income.

The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is tenable in law.

Question 28

A charitable trust, whose income can be exempt under section 11 of the Income-tax Act, 1961, was formed on 1st March, 2014. For the accounting year ended 31st March, 2017, it earned an income of ₹ 3,60,000.

It filed with the Commissioner of Income-tax its application for registration on 31st August, 2016 explaining that for good and sufficient reasons, it was prevented from filing the application for so long.

State:

(i) by which date the application for registration should have been filed;

(ii) whether such an application could have been filed before the formation of the trust;

(iii) in the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;

(iv) the steps to be taken by the trust to secure exemption from income-tax;

(v) whether a certificate of registration once granted can be cancelled and if so, the conditions there for.

Answer

(i) The requirement of filing an application for registration under section 12A within one year of creation of the trust has been removed. The application can be filed at any time now. Accordingly, the provisions of sections 11 and 12 would apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application was filed.

However, where registration has been granted to the trust under section 12AA and on the said date, assessment proceedings relating to earlier assessment years are pending, then, the benefit of sections 11 and 12 shall be available in respect of income derived from property held under trust in those years, provided the objects and activities of the trust remain unchanged.

(ii) No. The application for registration under section 12A cannot be filed before the formation of the trust.

(iii) As per section 12AA(2), every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A. The Supreme Court in, *CIT v. Society for Promotion of Education (2016) 382 ITR 6,* held that the trust would be deemed as registered if the application under section 12AA is not disposed of within the stipulated period of six months. Therefore, in this case, the trust would be deemed as registered with effect from 1st March, 2017. The benefit of exemption under section 11 and 12 would be available from A.Y. 2017-18, being the assessment year relevant to the financial year in which the application is made.

(iv) The following are the steps to be taken by the trust to secure exemption from income-tax:

(1) The trust should be registered with the Principal Commissioner or Commissioner of Income-tax under section 12AA.

(2) The accounts of the trust for the previous year must be audited by a Chartered Accountant if its total income without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to tax. The audit report in the prescribed form, duly signed and verified by the Chartered Accountant, should be furnished along with the return of income of the trust for the relevant assessment year.

(3) At least 85% of the income is required to be applied for the approved purposes.

(4) The unapplied income and the money accumulated or set apart should be invested or deposited in the specified forms or modes, after filing statement in Form 10 on or before the due date of filing return of income specified under section 139(1).

(v) Yes, the certificate of registration can be cancelled by the Commissioner. According to section 12AA, if the Commissioner is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall, after giving the trust a reasonable opportunity of being heard, pass an order in writing canceling the registration of the trust.

Further, section 12AA(4) provides that where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—

(i) its income does not enure for the benefit of general public;

(ii) it is for benefit of any particular religious community or caste;

(iii) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or

(iv) its funds are invested in prohibited modes,

then, the Commissioner may cancel the registration of such trust or institution. However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.

Question 29

How do you deal with the following situation? Give reasons for your answer.

Ramji Charitable Trust has filed return of income for the Assessment Year 2017-18 within the stipulated time under section 139(1) and applied only 50% of its income to specified purposes. It intends to accumulate the balance 35% of income to be spent in future years. While completing the assessment, the Assessing Officer disallowed the accumulated income of 35% and taxed the same on the ground that the trust has not made any application under Section 11(2) along with return of income. Discuss the validity of the action of the Assessing Officer in this case.

Answer

Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable or religious purposes and where 85% of its income is not applied in the aforesaid manner, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in the prescribed form, for accumulation of income, specifying the purpose and the period (not exceeding 5 years). The application should be filed or furnished before the assessing authority on or before the due date specified under section 139(1).

Further, the money so set apart or accumulated should be invested/deposited in any one or more of modes or forms specified under section 11(5).

Thus, this requirement of filing application is mandatory and without those particulars, the assessing authority cannot entertain the claim of the assessee under section 11. In case the statement in Form 10 is not submitted on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing of return of income under section 139(1). Therefore, the action of the Assessing Officer is correct.

Question 30

Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60%:

Particulars	***₹***
Cost of transferred asset	*2,40,000*
Sale consideration	*3,60,000*
Cost of new asset purchased	*3,00,000*

Answer

In this case, since the asset which is transferred is utilized for the purposes of the trust only to the extent of 60%, only the proportionate amount (i.e. 60%) of the capital gain would be regarded as having been applied for charitable or religious purposes.

As per section 11(1A), where a capital asset held under trust is transferred, and only a part of the net consideration is utilized for acquiring a new capital asset, only so much of the capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust.

In this case, only a part of the net consideration of ₹ 3,60,000 is utilized for acquiring the new capital asset costing ₹ 3,00,000. The amount utilized in acquiring the new asset (i.e. ₹ 3,00,000) exceeds the cost of the transferred asset (i.e. ₹ 2,40,000) by ₹ 60,000.

Therefore, only 60% of (₹ 3,00,000 – ₹ 2,40,000) = 60% of ₹ 60,000 = ₹ 36,000 is deemed to be applied for the objects of the trust.

Question 31

The following trusts claim that anonymous donations received by them during the financial year 2016-17 are not liable to tax under section 115BBC:

(i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.

(ii) A trust established wholly for religious purposes which applied 75% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts.

Answer

(i) Section 115BBC provides for levy of tax @ 30% on anonymous donation received by, *inter alia*, charitable trusts or institutions referred to in section 11 in the following manner:

(i) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or one lakh rupees, whichever is higher; and

(ii) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by the assessee or ₹ 1 lakh, as the case may be.

Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

However, a view may be taken that anonymous donation upto higher of 5% of total donations or 1 lakh, which is taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. Therefore, the claim made by the trust is valid in law. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

Question 32

An institution operating for promotion of education claiming exemption under section 11 since 1994 furnishes the following data for the assessment year 2017-18:

S. No.	*Particulars*	*₹ in crores*
(i)	*Fees collected from students*	*14*
(ii)	*Expenses incurred to run the institution*	*4*
(iii)	*Land acquired to be used as a cricket field for the students*	*2*

(iv)	*Amount earmarked and set apart for construction of an arts block within the next 4 years.*	*4*

Compute the total income of the institution for the A.Y.2017-18.

Answer

Computation of total income of the institution for the A.Y. 2017-18

Particulars	₹ (in crores)
Fees received	14.00
Less : Expenses incurred to earn the income	4.00
	10.00
Less : 15% (exempt even if not spent for the objects of the institution)	1.50
	8.50
Less : Accumulated for specified purpose **(See Note 2)**	4.00
Balance to be spent	4.50
Actual amount spent on purchase of land for cricket field **(See Note 1)**	2.00
Total income	**2.50**

Notes:

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the specified forms and modes. In this case, the institution has to furnish statement in Form 10 on or before the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years. Further, the institution has to invest ₹ 4 crore in the specified forms and modes.

Question 33

A public charitable trust registered under Section 12AA, for the previous year ending 31.3.2017, derived gross income of ₹ 21 Lacs, which consists of the following: (₹ in Lacs)

(a)	*Income from properties held by trust (net)*	*10*
(b)	*Income (net) from business (incidental to main objects)*	*4*
(c)	*Voluntary contributions from public*	*7*

The trust applied a sum of ₹ 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage ₹ 3.60 lacs.

Determine the taxable income of the trust for the assessment year 2017-18.

Answer

Computation of taxable income of public charitable trust

	Particulars	₹
(i)	Income from property held under trust (net)	10,00,000
(ii)	Income (net) from business (incidental to main objects)	4,00,000
(iii)	Voluntary contributions from public	7,00,000
	Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.	--
		21,00,000
	Less: 15% of the income eligible for retention / accumulation without any conditions	3,15,000
		17,85,000
	Less: Amount applied for the objects of the trust	
	(i) Amount spent for charitable purposes (₹ 11,60,000 - ₹ 3,60,000)	8,00,000
	(ii) Repayment of loan for construction of orphan home	3,60,000
	Taxable Income	**6,25,000**

Question 34

Gangaram Public Charitable Trust runs a hospital. The gross receipts from its operational activities is ₹ 250 Lacs and expenses incurred are ₹ 55 Lacs. Out of income of ₹ 250 Lacs, the amount accrued but not received as on 31-03-2017 is ₹ 20 Lacs. The institution earmarked and set apart ₹ 30 Lacs in March, 2017 to give as advance for a building intended to be taken on lease for expansion of the hospital, but the amount was paid on 7th April, 2017, as the lease agreement could not be signed by 31st March, 2017. The trust has got an ERP package developed and installed by an IT company during the year. The total cost to the trust on account of the ERP package was ₹ 85 Lacs. Advise the trust on its total income, if the trust has incurred ₹ 12 Lacs for purchase of a number of desktop and laptop computers for use in the hospital.

Answer

The total income of the trust for the A.Y. 2017-18 is computed hereunder:

Particulars	₹ (in Lacs)	
Gross receipts from Trust		250.00
Less: Expenses incurred thereto		55.00
Income derived from property held under trust		195.00

Less: 15% eligible for blanket exemption without any conditions (15% of ₹ 195 Lacs)		29.25
		165.75
Less: Income not received during the year, which can be spent in the year of receipt or in the immediately following year		20.00
		145.75
Less: Non-application of income due to delay in signing lease agreement [The amount was applied on 7th April in the immediately following year – Option to be exercised in writing before the expiry of the time allowed under section 139(1) for furnishing the return of income]		30.00
Amount to be applied for the objects of the trust by 31.3.2017		**115.75**
Less: Amount applied for the objects of the trust		
(i) For development and installation of ERP package for the purpose of the trust	85	
(ii) For purchase of desktop and laptop computers for the purposes of the trust	12	97
Taxable Income		**18.75**

Notes:

(i) Where the cost of assets is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

(ii) If the income applied to charitable purposes in India falls short of 85% of the income derived during the year from property held under trust for the reason that the whole or any part of its income has not been received during that year, then such income, at the option of the person in receipt of income, can be applied during the previous year in which the income is received or in the immediately following previous year. The option is to be exercised in writing before expiry of the time allowed under section 139(1) for filing return of income.

(iii) The word "applied" used in section 11 means that the income is actually applied for the charitable purposes of the trust. The word "applied" does not necessarily imply "spent". Even if a certain amount is irretrievably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes. *[CIT vs. Trustees of H.E.H. Nizams Charitable Trust, (1981) 131 ITR 497 (AP).]*

(iv) The cost of getting an ERP package developed and installed is a capital expenditure. A charitable trust can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the trust. Purchase of a fixed asset to be utilised for the purpose of the trust amounts to application of income for charitable purposes as held by the Supreme Court in *S.RM.M.CT.M.Tiruppani Trust vs. CIT (1998) 230 ITR 636.*

Question 35

A public charitable trust, created under a trust deed for providing relief to disabled persons, registered under section 12AA, furnishes the following particulars of its receipts during the year ended 31st March, 2017 -

	Particulars	*₹ (in Lacs)*
(i)	*Income from properties held by trust (net)*	*20*
(ii)	*Income (net) from business (incidental to main objects)*	*17*
(iii)	*Voluntary contributions from public (including the corpus donation of ₹ 5 Lacs)*	*11*

The trust applied ₹ 20 lacs towards various activities and programmes undertaken for the benefit of autistic persons during the year. The trust has also paid ₹ 10 lacs towards repayment of a loan taken a year back for the purpose of construction of its centre for training the disabled persons in various handicraft works.

Determine the tax liability, if any, of the trust for the assessment year 2017-18.

Answer

Computation of total income of the trust for the A.Y. 2017-18

Particulars	₹	₹
Income from properties held by trust	20,00,000	
Income from business incidental to the main objects of the trust	17,00,000	
Voluntary Contribution other than corpus donation **(Note 1)**	6,00,000	43,00,000
Less: 15% of income accumulated or set apart under section 11(1)(a)		6,45,000
		36,55,000
***Less:* Amount applied for charitable purposes**		
Activities and programmes for the benefit of autistic persons	20,00,000	
Repayment of loan taken for construction of training centre **(Note 2)**	10,00,000	30,00,000
Taxable Income		**6,55,000**

Computation of tax liability of the trust for the A.Y. 2017-18

Particulars	₹	₹
Upto ₹ 2,50,000	Nil	
₹ 2,50,000 – ₹ 5,00,000	25,000	
₹ 5,00,000 – ₹ 6,55,000	31,000	56,000
Add: Education cess @ 2%		1,120
Add: Secondary and higher education cess @ 1%		560
Total tax liability		**57,680**

Notes:

(1) Section 11(1)(d) excludes from the total income of the person, any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

(2) In *CIT vs. Janmabhoomi Press Trust (2000) 242 ITR 703,* the Karnataka High Court held that where a debt is incurred for the purpose of the trust, the repayment of the debt would amount to an application of the income for the purpose of the trust. Therefore, repayment of loan taken for construction of training centre for disabled persons is to be considered as application for charitable purpose.

Question 36

Ramamurty Public Charitable Trust (Registered under section 12AA of the Income-tax Act, 1961) furnishes the following data for the financial year ending 31.3.2017.

S.No.	*Particulars*	*₹ (in Lacs)*
(i)	*Income from Engineering College* *(Gross receipts ₹ 100 Lacs)*	*10*
(ii)	*Income from properties held in trust (out of this ₹ 2 Lacs was not received during the year and ₹ 2 Lacs was received only on the last day of the year)*	*26*
(iii)	*Net income from business held under trust (As incidental to the main objects) as per books*	*2*
(iv)	*Amount spent on free scholarship, free meals and fee medical relief*	*9*
(v)	*Repayment of loan taken for construction of Health Care Centre*	*3*

You are required to:

(a) Compute the taxable income of the Trust for the assessment year, 2017-18. Assume that option is exercised under Explanation to section 11(1) of the Act.

(b) Advise how the taxability on the computed income could be minimized or reduced.

Answer

(a) Computation of total income of Shri Ramamurthy Public Charitable Trust for A.Y. 2017-18

	Particulars	**₹(in Lacs)**
(i)	Income from Engineering College – exempt under section 10(23C)(iiiad) as gross receipts do not exceed ₹ 1 crore.	Nil
(ii)	Income from properties held under trust	26.00
(iii)	Income from business undertaking held under trust (assumed that the business is incidental to the attainment of objectives of the trust and separate books are maintained satisfying section 11(4A))	2.00
		28.00

	85% of the income required to be spent (85% of ₹ 28 Lacs)	23.80
	Less: Option exercised under *Explanation 2* to section 11(1)	
	(i) Amount not received during the previous year	2.00
	(ii) Income received on the last day to be spent in the next year	2.00
		19.80
	Less: Amount spent on free scholarship, free meals and free medical centre	9.00
	Repayment of loans for construction of health centre (this is utilized for the fulfillment of the objects of the trust) (See *CIT v.Janmbhoomi Press Trust (2000) 242 ITR 703)*	3.00
	Income of the trust liable to tax	**7.80**

(b) In order to minimize and / or reduce the tax liability, the trustees may give a notice in writing to the Assessing Officer in the prescribed manner about their intention to accumulate minimum of ₹ 5.30 lacs [₹ 7.80 lacs minus ₹ 2.50 lacs (basic exemption limit)] specifying the period and the purpose for which the accumulation is proposed to be made and invest such sum in specified assets as per section 11(5). This accumulation would be in compliance with section 11(2) and in such case, no tax will be payable on the whole sum of ₹ 7.80 lacs.

Question 37

A public charitable trust registered under section 12AA runs a hospital and also a medical college. It furnishes you the following information for the year ended 31st March, 2017:

(i) Gross receipt from Hospital ₹ 425 lakhs

(ii) Income from business - incidental to main objects ₹ 2 lakhs.

(iii) Voluntary contributions received from public ₹ 32 lakhs. It include corpus donation of ₹ 3 lakhs and anonymous donation of ₹ 5 lakhs.

***Note:** Voluntary contributions are included in Gross receipt given in (i) above.*

(iv) Hospital operational expenses incurred ₹ 105 lakhs. (This does not include capital expenditures and depreciation)

(v) Income from Medical College (solely for education purpose) ₹ 10 lakhs. Gross receipts of college for the year ₹ 90 lakhs.

(vi) Gross receipt given in (i) above includes a sum of ₹ 55 lakhs which has accrued but not received. Further, a sum of ₹ 18 lakhs was received only on 31st day of March, 2017.

(vii) The trust set apart ₹ 80 lakhs for acquiring a building to expand its hospital. But the amount was paid in December, 2017 when sale deed was registered in its name.

(viii) In June, 2015, the trust purchased and installed new computer software for ₹ 28 lakhs. The rate of depreciation is 60% as per Income-tax Act, 1961.

(ix) *The trust incurred ₹ 35 lakhs towards purchase of laptops, computers and printers for the hospital.*

(x) *It repaid loan of ₹ 15 lakhs taken earlier for construction of hospital building.*

Compute the total income of the trust for the assessment year 2017-18 in order to avail maximum benefits within the four comers of law.

Answer

Computation of total income of the trust for the A.Y.2017-18

Particulars	(₹ in lacs)	(₹ in lacs)
Gross receipts from Hospital (other than voluntary contribution of ₹ 32 lakhs) [₹ 425 lacs – ₹ 32 lacs]		393.00
Less: Hospital operational expenses		105.00
		288.00
Income from business – incidental to main object[1]		2.00
		290.00
Add: Voluntary contributions other than corpus donations of ₹ 3 lakhs		29.00
		319.00
Less: Anonymous donation taxable@30% under section 115BBC *[See Note 1]*		3.40
		315.60
Less: 15% of income eligible for accumulation or being set apart without any condition under section 11(1)(a)[2]		47.34
		268.26
Less: Deemed application as per *Explanation 2* to section 11(1)[3]		
(i) Amount accrued but not received during the previous year	55.00	
(ii) Income received on 31st March 2017	18.00	73.00
		195.26
Less: Amount applied for the purposes of hospital [See Note 2]		
- Cost of new computer software [Assuming that the same was purchased for the purposes of the hospital]	28.00	

[1] It is assumed that separate books of account are maintained by the trust in respect of such business

[2] A possible alternate view arising on account of the interpretation of the Supreme Court ruling in *CIT v. Programme for Community Organisation (2001) 116 Taxman 608* is that 15% of gross receipts would be eligible for accumulation under section 11(1)(a).

[3] It is assumed that an option has been exercised in writing before the expiry of the time allowed under section 139(1) to treat such income as deemed application of income in the previous year in which the income is derived.

- Cost of laptops, computers and printers purchased for the hospital *[Capital expenditure can be claimed as application of income. It was so held in S.RM.M.CT.M. Tiruppani Trust v. CIT (1998) 230 ITR 636]*	35.00	
- Repayment of loan taken earlier for construction of hospital building - repayment of a debt incurred for the purpose of trust is application of income *[CIT v. Janmbhoomi Press Trust (2000) 242 ITR 703 (Kar.)]*	15.00	78.00
		117.26
Less: Amount set apart for acquisition of a building to expand its hospital [See Note 3] [The amount spent in December, 2017 in the immediately following year can be treated as application in the P.Y.2016-17, provided the statement in prescribed form (i.e., Form 10) is given to the Assessing Officer on or before the due date under section 139(1)].		80.00
		37.26
Income of ₹ 10 lakhs from Medical College – exempt under section 10(23C)(iiiad) as gross receipts do not exceed ₹ 1 crore.		Nil
Total income [other than anonymous donation taxable under section 115BBC]		**37.26**
Add: Anonymous donation taxable @30%		3.40
Total Income of the trust (including anonymous donation taxable@30%)		**40.66**
In order to minimize and / or reduce the tax liability, the trustees may give a notice in writing to the Assessing Officer in the prescribed manner about their intention to accumulate minimum of ₹ 34.76 lakhs [₹ 37.26 lakhs *minus* ₹ 2.50 lakhs (basic exemption limit)] specifying the period and the purpose for which the accumulation is proposed to be made and invest such sum in the modes specified under section 11(5). This accumulation would be in compliance with section 11(2) and in such a case, no tax will be payable on the total income (other than anonymous donations taxable@30% under section 115BBC) of ₹ 37.26 lakhs.		

Notes:

(1) As per section 115BBC(1), the anonymous donations in excess of the higher of the following would be subject to tax@30%;

- ₹ 1.60 lakh, being 5% of the total donations received i.e., 5% of ₹ 32 lakh; or
- ₹ 1 lakh

Therefore, anonymous donations of ₹ 3.4 lakh (₹ 5 lakh – ₹ 1.60 lakh) would be subject to tax@30% under section 115BBC.

As per section 13(7), such anonymous donations are not eligible for the benefit of exclusion from total income under sections 11 and 12.

(2) As per section 11(6), where the cost of assets is claimed as application, no deduction for depreciation on such assets would be allowed in determining income for the purposes of application. Therefore, since cost of new computer software, laptops, computers and printers purchased for the hospital has been claimed as application of income, no depreciation would be allowed on these assets while determining income for the purposes of application.

(3) The word "applied" used in section 11 does not necessarily imply "spent". Even if a certain amount is irretrievably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes. *[CIT vs. Trustees of H.E.H. Nizams Charitable Trust, (1981) 131 ITR 497 (AP).]*

(4) A view is taken that 15% of ₹1.60 lakhs, representing the amount of anonymous donations exempt from the applicability of tax@30% (and hence, chargeable to tax at normal rates), is also eligible for retention/ accumulation without conditions in line with other voluntary contributions. The above solution has been worked out on the basis of this view.

However, it is possible that the language used in section 13(7) may also be interpreted to mean that anonymous donations chargeable to tax at normal rates are not eligible for retention/accumulation. In such a case, the whole of the anonymous donations of ₹ 5 lakhs has to be deducted from ₹ 319 lakhs to arrive at ₹ 314 lakhs and 15% of ₹ 314 lakhs, being ₹ 47.10 lakhs, would be eligible for accumulation under section 11(1)(a) without any condition.

Question 38

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2017 in following case shall be subject to tax in the A.Y. 2017-18:

A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of ₹ 1,25,000 per month of one of its building let out to a bank from 01.06.2016.

Answer

Rent received by the political party from the bank is an income chargeable under the head "Income from house property". However, according to the provisions of section 13A, income from, *inter alia*, house property shall not be included in total income of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfills the conditions as specified therein. Therefore, rent of ₹ 1,25,000 received by the registered political party from letting out of its building to a bank would not be included in its total income.

Question 39

The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2017 disclose the following receipts:

(a)	*Rent of property let out to a departmental store at Chennai*	*₹ 6,00,000*
(b)	*Interest on deposits other than banks*	*₹ 5,00,000*
(c)	*Contributions from 100 persons (who have secreted their names) of ₹ 11,000 each*	*₹ 11,00,000*
(d)	*Contribution @ ₹ 11 each from 1,00,000 members by cheque (recorded in books of account)*	*₹ 11,00,000*
(e)	*Net profit of cafeteria run in the premises at Delhi*	*₹ 3,00,000*

Compute the total income of the political party for the assessment year 2017-18, with reasons for inclusion or otherwise.

Answer

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person, on fulfilling of the conditions as mentioned thereunder are exempt from tax. In this case assuming that the National Political Party fulfills all the conditions mentioned thereunder, the income is computed as under:

Computation of total income of National Political Party

	Particulars	₹
(a)	The rent of the property of ₹ 6 lacs located at Chennai	Nil
(b)	The interest received on deposits of ₹ 5 lacs	Nil
(c)	The contributions given by 100 persons of ₹ 11,000 each by secreting their identities (See Note below)	Nil
(d)	The contribution of ₹ 11 each given by its members being recorded in the books	Nil
(e)	Net profit of cafeteria at Delhi	3,00,000
	Total Income	**3,00,000**

Note: *In respect of each voluntary contribution in excess of ₹ 20,000, exemption would be available only if the political party keeps and maintains a record of such contribution and the name and address of the person who has made such contribution. However, in this case, this provision is not attracted since the contribution given by each person is less than ₹ 20,000.*

Question 40

Which are the conditions to be satisfied by an electoral trust for claiming the benefit of exemption of its income? Is this benefit available in respect of all the income earned by an electoral trust?

Answer

An approved electoral trust is eligible for exemption under section 13B in respect of voluntary contributions received by it.

The voluntary contributions received by such electoral trust shall be treated as its income under section 2(24), but shall be exempt under section 13B, if the electroral trust:-

(i) distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with the surplus, if any, brought forward from any earlier previous year.

(ii) functions in accordance with the rules made by the Central Government. Rule 17A has been notified, which would govern the functioning of Electoral Trusts for claim of exemption under section 13B.

The benefit under section 13B is available only in respect of voluntary contribution received by an electoral trust and not in respect of its other income.

Question 41

An electoral trust approved by the CBDT is not liable to income-tax in respect of voluntary contribution received and other income - Discuss the correctness of the statement.

Answer

Section 13B provides exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would be treated as its income under section 2(24), but shall be exempt under section 13B if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with surplus brought forward from any earlier years. Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

Question 42

"Charitable trusts and institutions registered under section 12AA, cannot claim exemption under any of the clauses of Section 10". Discuss the correctness of this statement.

Answer

The statement is partially correct.

Where a trust or institution has been granted registration under section 12AA and the registration is in force for a previous year, then, such trust or institution can still claim exemption of agricultural income under section 10(1) as well as exemption available under section 10(23C).

Therefore, the statement that such trust or institution cannot claim exemption under any of the clauses of section 10 is not fully correct, since it can still claim exemption under section 10(1) and under section 10(23C).

Exercise

1. (a) *Discuss the exemption available under the Income-tax Act in respect of specified income arising from any international sporting event in India.*

   (b) *What are the exemptions available under section 10 in respect of companies engaged in the business of generation or transmission or distribution of power and subsidiaries of such companies? What are the conditions to be fulfilled to avail such exemptions?*

2. *Discuss the provisions of section 10AA in respect of tax holiday for newly established units in a special economic zone.*

3. *When can a charitable trust avail benefits under section 11 & 12 of the Income-tax Act, 1961?*

4. *Discuss the meaning and tax treatment of anonymous donations received by charitable/religious trusts/institutions.*

5. *Mr. Ganesh, an employee of a co-operative bank, received a certain sum by way of leave encashment while in service from his employer, in respect of which he claimed exemption under section 10(10AA), on the contention that the words 'or otherwise' in section 10(10AA) clearly indicated that the exemption was to be given as and when there was a payment to the assessee in lieu of leave encashment and the words 'or otherwise' therein did not restrict the purview of the exemption to retiring employees only. Is Mr. Ganesh correct in claiming exemption under section 10(10AA) in respect of leave encashment received by him while in service? Discuss.*

Answer

5. This issue came up before the *Allahabad High Court in CIT v. Ashok Kumar Dixit (2005) 273 ITR 126*. The High Court observed that the words 'or otherwise' would draw the restricted meaning *qua* the immediately preceding word 'superannuation'. The superannuation is of an employee's severance of relationship of contract of employment with the employer. The phrase 'or otherwise' would cover only such an eventuality when there is severance of relationship of employer and employee and contract of employment. Therefore, the phrase 'or otherwise' will not cover such cases where there is no severance of relationship of employer and employee and the assessee continues to be under the employment of the same employer, and receives leave encashment. The Court held that this interpretation is in consonance with the legislative history of the section and it manifests the intention of the Legislature to give a limited benefit to an employee with respect to the income received by the employee at the time of his retirement or superannuation or severance of relationship.

Therefore, in view of the above case, exemption under section 10(10AA) cannot be claimed by Mr. Ganesh in respect of leave encashment received by him while in service from his employer.

4

Income from Salaries

Question 1

Examine the correctness or otherwise of the following case in the context of provisions contained in the Income-tax Act, 1961 relevant/applicable for the assessment year 2017-18:

(i) *Nargis, working as Regional Area Sales Manager of Pincer Marketing Ltd., was paid salary and a commission based as a percentage on the volume of sales effected by her. Nargis claimed the expenses incurred by her for earning the commission in the return of income, which were disallowed by the Assessing Officer.*

(ii) *An amount of ₹ 12,50,000 paid by XYZ Ltd., after approval by the board, to a hospital in UK for the heart surgery of its managing director was charged under medical expenses. The Assessing Officer, while completing the assessment of the company, taxed the amount so paid by the company as a perquisite in the hands of its Managing Director.*

Answer

(i) The facts of this case are similar to the case decided by the Madras High Court in *CIT v. R. Rajendran (2003) 260 ITR 0476*, where it was held that since the assessee was employed as a regional sales manager and the commission paid to him is based on the volume of sales effected, such commission was obviously paid to the employee as an encouragement to effect a higher level of sales. The commission paid in addition to what the employee was getting as a fixed salary would also constitute/form part of salary. When the commission is chargeable as salary, then no deduction is allowable in respect of any expenditure incurred to earn the commission.

Therefore, in this case, the claim made by Nargis is not valid and the expenses incurred for earning commission are not allowable as deduction while computing her salary income.

(ii) A Managing Director generally occupies the dual capacity of being a director as well as an employee of the company. In this case, assuming that the Managing Director is also an employee of XYZ Ltd., clause (vi) of the proviso to section 17(2) would get attracted. Clause (vi) of the proviso to section 17(2) provides that any expenditure incurred by the employer on medical treatment of the employee outside India shall be excluded from perquisite only to the extent permitted by RBI. Therefore, the expenditure on medical treatment of the Managing Director outside India shall be excluded from perquisite to the extent permitted by RBI as per clause (vi) of the proviso to section 17(2). If it is assumed that the entire amount is permitted by RBI, there would be no perquisite chargeable in the hands of the Managing Director. Therefore, in such a case, the action of the Assessing Officer in taxing the entire amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

This question can also be answered by applying the rationale of the Allahabad High Court ruling in *CIT v. D.P. Kanodia (2008) 296 ITR 0616*. In that case, the High Court observed that the reimbursement by the company of medical expenditure incurred outside India by the director cannot be considered as an amenity or benefit provided by the company to its director, and therefore the provisions of section 17(2)(iii)(a) would not be attracted. Therefore, such reimbursement was not a perquisite within the meaning of section 17(2)(iii)(a).

Hence, applying the rationale of the above case to the facts of this case, the action of the Assessing Officer in taxing the amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

Question 2

Ayush, an employee of a management consultancy firm, was sent to UK in connection with a project of the firm's client for two months in the previous year. In addition to his salary, the firm paid per diem allowance for the period when he worked in UK to meet expenses on boarding and lodging. Tax was not deducted at source from such allowance by the employer. Ayush did not include such allowance in computation of his taxable salary for the relevant assessment year. In course of assessment of Ayush under section 143(3), the Assessing Officer sent a notice to him asking him to explain why the per diem allowance received by him should not be charged to tax? Ayush has sought your advice.

Answer

Per-diem allowance is exempt from tax under section 10(14)(i) read with Rule 2BB, as it is an allowance granted and spent to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty. Rule 2BB exempts the allowance granted to meet the ordinary daily charges incurred by an employee on account of his absence from his normal place of duty. In the given case, Mr. Ayush was posted for a period of 2 months outside his normal place of duty and the allowance was paid to meet the boarding and lodging. Therefore, the allowance would fall under section 10(14)(i) read with Rule 2BB and would hence be exempt, assuming that expenditure to that extent was actually incurred for his boarding and lodging.

Question 3

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

Answer

The facts of this case are similar to the facts in *CIT v. Shiv Charan Mathur (2008) 306 ITR 126 (Raj.).* In the instant case, the High Court observed that MPs and MLAs do not fall within the meaning of "employees". They are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations. The remuneration received by them, after swearing in, cannot be said to be salary within the meaning of section 15, since the basic ingredient of employer-employee relationship is missing in such cases.

Therefore, the remuneration received by MPs and MLAs is taxable under the head "Income from Other Sources" and not under the head "Salaries". When the provisions of section 15 are not attracted to the remuneration received by MPs and MLAs, the provisions of section 17 also would not apply as section 17 only extends the definition of salary by providing that certain items mentioned therein would be included in salary as "perquisites". Thus, reimbursement of medical expenditure (incurred for open heart surgery abroad) to an MLA cannot be taxed as a perquisite under section 17.

Applying the above ruling to the case on hand, the contention of the Assessing Officer is not correct.

Question 4

Mr. Kadam is entitled to a salary of ₹ 25,000 per month. He is given an option by his employer either to take house rent allowance or a rent free accommodation which is owned by the company. The HRA amount payable was ₹ 5,000 per month. The rent for the hired accommodation was ₹ 6,000 per month at New Delhi. Advice Mr. Kadam whether it would be beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis of "Net Take Home Cash benefits".

Answer

Computation of tax liability of Kadam under both the options

Particulars			Option I – HRA (₹)	Option II – RFA (₹)
Basic Salary (₹ 25,000 x 12 Months)			3,00,000	3,00,000
Perquisite value of rent-free accommodation (15% of ₹ 3,00,000)			N.A.	45,000
House rent Allowance (₹ 5,000 x 12 Months)		₹ 60,000		
Less: Exempt u/s 10(13A) – least of the following -				
- 50% of Basic Salary	₹ 1,50,000			
- Actual HRA	₹ 60,000			
- Rent less 10% of salary	₹ 42,000	₹ 42,000	18,000	

Income taxable under the head "Salaries"	3,18,000	3,45,000
Less: Deduction under Chapter VIA	-	-
Total Income	**3,18,000**	**3,45,000**
Tax on total income	6,800	9,500
Less: Rebate u/s 87A (Since total income is less than ₹ 5,00,000)	5,000	5,000
	1,800	4,500
Add: Education cess@1% and SHEC @ 2%	54	125
Total tax payable	**1,854**	**4,635**

Cash Flow Statement

Particulars	Option I – HRA	Option II – RFA
Inflow : Salary	3,60,000	3,00,000
Less: Outflow: Rent paid	(72,000)	-
Tax on total income	(1,854)	(4,635)
Net Inflow	**2,86,146**	**2,95,365**

Since the net cash inflow under option II (RFA) is higher than in Option I (HRA), it is beneficial for Mr. Kadam to avail Option II, i.e., Rent free accommodation.

Question 5

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961 for A.Y. 2017-18:

Pankaj, a salaried employee, received from his employer medical allowance of ₹ 12,000 and reimbursement of ₹ 16,000 on account of medical facilities.

Answer

The medical allowance of ₹ 12,000 received by Pankaj from his employer shall be chargeable to tax under the head income from salary as per section 17(1).

However, according to clause (v) of proviso to section 17(2), out of reimbursement of ₹ 16,000 on account of medical facilities, an amount of ₹ 15,000 will be exempt and only the balance of ₹ 1,000 will be the chargeable value of perquisite.

Question 6

Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 13.6.2016:

₹

	Car	*Laptop*	*Furniture*
Cost of Purchase (May 2014)	*8,72,000*	*1,22,500*	*35,000*
Sale Price	*5,15,000*	*25,000*	*10,000*

The assets were put to use by the company from the day these were purchased.

Answer

The assets transferred by the company shall be considered for the purpose of valuation of perquisites under section 17(2) of the Act read with Rules. The value of perquisite in respect of assets transferred is determined after allowing normal wear & tear for the period of use of such assets by employer.

	Car	***Laptop***	***Furniture***
Rate of Depreciation	20%	50%	10%
Basis of Depreciation	WDV	WDV	SLM
Cost of asset to company – May 2014	8,72,000	1,22,500	35,000
Less: Normal wear & tear upto May, 2015	1,74,400	61,250	3,500
	6,97,600	61,250	31,500
Less: Normal wear and tear upto May, 2016	1,39,520	30,625	3,500
Balance, in May, 2016	5,58,080	30,625	28,000
Less: Sale value on 13.06.2016	5,15,000	25,000	10,000
Value of Perquisite	**43,080**	**5,625**	**18,000**

Note: *As per Rule 3(7) of Income-tax Rules, 1962 normal wear and tear has to be calculated at the aforementioned prescribed rates applying Straight Line Method (SLM) to Furniture and Written Down Value (WDV) method to all other assets.*

Question 7

IT Limited, under its Employment Stock Option Plan, allotted 500 equity shares to its finance manager, Ms. Cynthia on 15th May, 2016, when she exercised her option. The option was granted on 15th January, 2015 and the shares vested with Cynthia on 15th January, 2016. The company's shares are quoted in Bombay Stock Exchange, where the opening price and closing price on the date of exercise of option were ₹ 250 and ₹ 256, respectively. The company recovered ₹ 50 per share from Cynthia. Compute the value of perquisite for the assessment year 2017-18.

Answer

Allotment of shares under the Employees' Stock Option Plan (ESOP) is liable to tax as perquisite in the hands of employees. The fair market value of shares on the date on which the option is exercised by the employee as reduced by the amount actually paid by or recovered from the employee in respect of such shares would be the value of perquisite.

As per Rule 3(8), in case of shares listed in one recognized stock exchange, fair market value means the average of opening price and closing price of the share on the said stock exchange as on the date of exercise of option.

Therefore, in this case, the fair market value would be $\frac{250+256}{2}$ = ₹ 253

Thus, the value of perquisite would be = (₹ 253 x 500) - (₹ 50 x 500) = ₹ 1,01,500.

Question 8

Mr. M is working with MNO Limited for the last 10 years. He was granted an option on 1.7.2014 by the company to purchase 800 equity shares at a price of ₹ 250 per share. The period during which the option can be exercised to purchase 800 shares at a pre-determined price of ₹ 250 per share commencing on 1.7.2014 and ending on 31.3.2017. Mr. M exercised the option on 15.3.2016 to purchase 500 shares. Fair market value on the said date was ₹ 6490 on the Bombay Stock Exchange and ₹ 6500 on the National Stock Exchange. The NSE has recorded the higher volume of trading in that share.

The company has allotted him 500 shares on 24th April, 2016. The fair market value on the date of allotment was ₹ 7100 per share on NSE and ₹ 7110 on the BSE that has recorded the higher volume of trading in that share. The option was granted for making available rights in the nature of intellectual property rights.

Determine the taxability of perquisite. Does it make any difference if the option was granted for providing technical know-how?

Answer

The perquisite of sweat equity shares shall be taxable in the previous year 2016-17 (assessment year 2017-18), being the previous year of allotment of such shares. The value of sweat equity shares shall be the fair market value of such shares on the date on which the option is exercised by the assessee, as reduced by any amount actually paid by, or recovered from, the assessee in respect of such shares.

As per Rule 3(8) of the Income-tax Rules, 1962, the fair market value of a share on the date of exercising the option shall be the price of the share on the recognized stock exchange which records the highest volume of trading in such shares, in case the shares are listed on more than one recognised stock exchange.

Hence, the value of taxable perquisite for sweat equity shares

=	FMV on the date of exercising the option on the NSE (since it recorded higher volume that BSE)	(-) Amount recovered from the employee
=	(500 × ₹ 6500) - (500 × ₹ 250)	
=	₹ 32,50,000 - ₹ 1,25,000 = ₹ 31,25,000	

As per section 17(2)(vi), "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 technical knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Therefore, this provision is equally applicable whether the sweat equity shares option was granted for making available rights in the nature of intellectual property rights or for providing technical know-how.

Question 9

Ranjit has taken an interest-free loan of ₹ 10 lacs from his company. The amount is utilized by him for purchasing a house on 30-06-2015. The house is self-occupied. As per the scheme of the company, loan would be recovered in 40 equal monthly instalments recoverable immediately after the completion of 18th month from the date of purchase. Assuming the SBI lending rate of similar loan on 1.4.2016 was 9.75%. Calculate the perquisite value of such loan in the hands of Ranjit for the assessment year 2017-18. Is it possible to get deduction of perquisite value of interest under section 24(b)? Does it make any difference, if the house is given on rent?

Answer

First instalment will be due on 1st January, 2017. Amount of instalment will be:

₹ 10,00,000 ÷ 40 = ₹ 25,000.

Therefore, value for perquisite for interest-free loan will be calculated by applying the interest rate charged by the State Bank of India on the first day of the relevant previous year, on the outstanding amount of loan as reduced by the interest, if any, actually paid by the employee. Therefore, the value of perquisite will be as follows:

		₹
From April 16 to Dec. 16	(10,00,000 x 9.75% x 9/12)	73,125
For the month of Jan. 17	(9,75,000 x 9.75% x 1/12)	7,922
For the month of Feb. 17	(9,50,000 x 9.75% x 1/12)	7,719
For the month of Mar. 17	(9,25,000 x 9.75% x 1/12)	7,516
	Total	**96,282**

Therefore, the perquisite value of interest-free loan will be ₹ 96,282.

Interest on capital borrowed for the purchase, construction, re-construction, repair or renewals of house property is deductible under section 24(b). In this case, capital is borrowed from the employer without interest. There is no interest paid or payable in respect of the amount of loan of ₹ 10 lacs. Consequently, no deduction under section 24(b) would be available, whether the house is self-occupied or let out.

Question 10

Calculate the value of perquisite, if any, chargeable to tax in respect of free accommodation provided by the employer in a hotel to an employee, for the previous year ended 31.3.2017:

(i) For 10 days when he was transferred from Delhi to Mumbai.

(ii) Throughout the year as per contract of employment.

Answer

(i) As per Rule 3, if the hotel accommodation is provided to the employee by the employer for a period not exceeding 15 days and such accommodation is provided on employee's transfer from one place to another, it is not a chargeable perquisite. In this case, the employer has provided accommodation in a hotel for a period of only 10 days. Hence, it is not a chargeable perquisite.

(ii) The employee was provided under a contract; accommodation in a hotel free of charge for throughout the year and accordingly the value of perquisite will be 24% of salary of the employee or the actual charges paid or payable to the hotel, whichever is less. The calculation shall be for the period during which such accommodation is provided and the value shall be reduced by the rent, if any, actually paid or payable by the employee.

Question 11

Ajay is employed as senior executive of Manu Ltd. Manu Ltd offers rights to its existing shareholders in the ratio 1:1 on 15th February 2017 at ₹ 150 per share. Ajay was offered 500 shares at ₹ 150, which he exercised. On these facts you are consulted by Ajay as to:

(a) The tax consequences for the assessment year 2017-18 assuming that fair market value on the date of exercise of option is ₹ 300.

(b) If Ajay is already a shareholder of 250 shares, allotted in public issue will it make any difference?

Answer

(a) As per section 17(2)(vi), the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee employee is taxable as perquisite. The meaning of the terms 'specified security', 'sweat equity shares', 'fair market value' are dealt with in the Explanation given therein.

The fair market value of the shares so determined in accordance with the method as may be prescribed less the amount actually recovered from the employee, shall be the value of perquisite chargeable to tax.

The value of perquisite would be:

	₹
Fair market value of shares determined as per the prescribed method in Income-tax Rules, 1962 = 500 shares @ ₹ 300 each	1,50,000
Less: Amount recovered from the employee @ ₹ 150 per share	75,000
Value of perquisite chargeable to tax	75,000

As per section 49(2AA), the cost of acquisition of specified security or sweat equity shares referred to in section 17(2)(vi) shall be the fair market value which has been taken into account for the purpose of perquisite valuation.

(b) In case the employee is a shareholder and was allotted shares in the same manner as was allotted to other shareholders by the company without any concession / reduction in value then the question of valuation of perquisite would not arise.

Question 12

A, an individual, has income taxable only under the head 'salaries'. In the course of the previous year ended 31st March, 2017, he pays ₹ 10,000 to an institution recognized by the prescribed authority under section 35CCA of the Income-tax Act, 1961.

Will A be entitled to any deduction under the Act and if so, in what an amount? Discuss.

Answer

The question is whether the deduction of the amount paid to an institution recognised by the prescribed authority under section 35CCA is available to a person, deriving income under the head "Salary".

Section 80GGA permits the deduction to all assessees, other than an assessee whose gross total income includes income chargeable under the head "Profits and gains of business or profession" in respect of sum paid to an association or institution which has, as its object the undertaking of any program of rural development, to be used for carrying out any program of rural development approved for the purposes of section 35CCA. Mr. A fulfils this condition. Therefore, he is eligible for 100% deduction of the amount paid by him to the institution under section 80GGA, on fulfilment of the conditions prescribed thereunder.

Note: *Deduction under section 35CCA is allowable while computing business income of an assessee. Since Mr. A does not have income under the head "Profits and gains of business or profession", deduction in respect of sum paid to approved institution is allowable under section 80GGA from gross total income.*

Question 13

Discuss the taxability of the balance amount withdrawn by an employee from the recognized provident fund at the time of leaving the service.

Answer

The accumulated balance withdrawn from the recognised provident fund account would not be taxable in the hands of the employee, if any of the following conditions are satisfied -

(a) the employee has rendered continuous service with his employer for a period of five years or more; or

(b) the employee is not able to fulfill the above condition of such continuous service due to his/her service having been terminated by reason of his/her ill health, or by the contraction or discontinuance of the employer's business or due to some other reason beyond the control of the employee; or

(c) on cessation of employment, the employee obtains another employment and the accumulated balance due and becoming payable to him, is transferred to his individual account in any recognized provident fund maintained by such other employer;

If the accumulated balance becomes taxable due to non-fulfillment of any of the aforesaid conditions, the total income of the employee will be recomputed by the Assessing Officer, as if the fund was not recognized from the beginning, and the employee shall be liable to pay the additional tax due along with the tax liability in the current year.

Question 14

Simran Pharma Ltd., a manufacturer of drugs and pharma products, provides the following information relating to payments made to Mr. Ram, its marketing manager in the financial year 2016-17:

- *Salary @ ₹ 20,000 p.m.*
- *Motor-cycle purchased for ₹ 45,000 in June, 2016 was given free of cost.*
- *Conveyance allowance of ₹ 5,000 p.m. which was fully spent for official purposes.*
- *Reimbursement of medical expenses actually incurred by him of ₹ 17,500.*

The company asks you to compute the total income chargeable to tax in the hands of marketing manager Mr. Ram.

Answer

Computation of total income of Mr. Ram

Particulars	₹
Salary	2,40,000
Free Motor cycle	45,000
Conveyance allowance fully spent for official purposes is exempt under section 10(14) for employee and totally tax free perquisite	Nil
Reimbursement of medical expenses (Reimbursement up to ₹ 15,000 is exempt in the hands of the employee and the excess is taxable)	2,500
Total Income	**2,87,500**

Question 15

Raghav has been in the service of a private company since 1st January, 1999, in Kolkata. During the financial year ending 2016-17 up to the date of retirement, he received from the company, salary @ ₹ 12,000 p.m., dearness allowance @ ₹ 2,000 p.m., city compensatory allowance @ ₹ 300 p.m., entertainment allowance @ ₹ 1,000 per month and house rent allowance @ ₹ 4,000 p.m. He resides in the house property owned by his HUF for which he *pays a rent of ₹ 4,500 p.m. He contributes ₹ 1,400 p.m. to the recognized provident fund. The company is also contributing an equal amount.*

Raghav retired from the service of the company on 31.12.2016 when he was paid a gratuity of ₹ 80,000 and pension of ₹ 6,000 p.m. He is not covered under the Payment of Gratuity Act, 1972. On 1.2.2017, he got one-half of the pension commuted and received ₹ 1,80,000 as commuted pension. He also received ₹ 3,00,000 as the accumulated balance of the recognised provident fund.

Compute his income under the head salary for the A.Y. 2017-18.

Answer

Computation of income under the head "Salaries" for the A.Y.2017-18

Particulars	₹
Salary (₹ 12,000 x 9)	1,08,000
Dearness allowance (₹ 2,000 x 9)	18,000
City compensatory allowance (₹ 300 x 9)	2,700
Entertainment allowance (₹ 1,000 x 9)	9,000
House rent allowance [See Note 1]	6,300
Pension (Uncommuted) (₹ 6,000 + ₹ 3,000 × 2) [See Note 4]	12,000
Commuted pension (₹ 1,80,000 – ₹ 1,20,000) [See Note 3]	60,000
Gross salary	**2,16,000**
Less: Deduction under section 16 [See Note 5]	Nil
Income from salary	**2,16,000**

Note -

1. As per section 10(13A), house rent allowance will be exempt to the extent of minimum of the following three amounts:

   (i) 50% of salary i.e. ₹ 54,000 (Assuming the dearness allowance is not included in for superannuation benefits).

   (ii) Rent paid minus 10% of salary i.e., ₹ 4,500 – ₹ 1,200 = ₹ 3,300 x 9 = ₹ 29,700

   (iii) HRA received ₹ 4,000 x 9 = ₹ 36,000

   Therefore, out of ₹ 36,000, ₹ 29,700 will be exempt and the balance ₹ 6,300 will be included in Gross Salary.

2. Gratuity of ₹ 80,000 is fully exempt under section 10(10)(iii), being the minimum of the following amounts:

   (i) Actual gratuity received, i.e., ₹ 80,000

(ii) Half month's average salary for every completed year of service i.e.,

$$\frac{\text{Average monthly salary}}{2} \times 18 \text{ i.e. } \frac{12{,}000 \times 18}{2} = ₹\ 1{,}08{,}000$$

(iii) Notified limit i.e., ₹ 10,00,000

3. As Raghav is receiving gratuity, one-third of commuted pension will be exempt and the balance would be taxable. 50% of the pension commuted is ₹ 1,80,000. Therefore, 100% would be ₹ 3,60,000 and one-third of the same would be ₹ 1,20,000. The taxable portion of the commuted pension would be ₹ 60,000 (i.e. ₹ 1,80,000 - ₹ 1,20,000).
4. Since employer's contribution to recognized provident fund is less than 12% of salary, it is not taxable. Accumulated balance of the recognized provident fund received is exempt from tax, since Raghav has rendered continuous service of more than five years.
5. Deduction under section 16(ii) in respect of entertainment allowance can be claimed only by Government employees. Therefore, Raghav is not eligible for any deduction in respect of entertainment allowance received by him.
6. Pension of January 2017 ₹ 6,000 plus pension after commutation (₹ 6,000 less 50%) ₹ 3,000 for February and March 2017. (₹ 6,000 + ₹ 3,000 + ₹ 3,000).
7. Accumulated balance of the recognised provident fund is not taxable since Raghav has been in continuous service with the employer for more than 5 years.

Question 16

Babu joined a company on 01.06.2016 at Mumbai and was paid the following emoluments and allowed perquisites as under:

Emoluments :	*Basic pay*	*₹ 25,000 per month*
	D.A.	*₹ 10,000 per month*
	Bonus	*₹ 50,000 per annum*

Perquisites:

(i) Furnished accommodation owned by the employer and provided free of cost

(ii) Value of furniture therein ₹ 3,00,000

(iii) Motor-car owned by the company (with engine c.c. less than 1.6 litres) along with chauffeur for official and personal use. Repair & maintenance expenses are borne by the employer.

(iv) Sweeper salary paid by company ₹ 1,500 per month

(v) Watchman salary paid by company ₹ 1,500 per month

(vi) Educational facility for 2 children provided free of cost. The school is owned and maintained by the company.

(vii) Interest free loan of ₹ 5,00,000 given on 1.10.2016 for purchase of a house. No

repayment was made during the year. SBI interest rate for similar loan to be taken as 10% p.a. on 01.04.2016

(viii) *Interest free loan given for purchase of computer ₹ 50,000 on 1.1.2017. No repayment was made during the year. SBI interest rate for similar loan is 16.50% p.a. on 01.04.2016*

You are required to compute the income of Babu under the head "Salaries" in respect of assessment year 2017-18.

Answer

Computation of income from salaries of Mr. Babu for A.Y.2017-18

Particulars	₹
Basic pay (₹ 25,000 x 10)	2,50,000
Dearness Allowance (₹ 10,000 x 10)	1,00,000
Bonus	50,000
	4,00,000
Perquisites-	
Rent free accommodation (assumed that D.A is not included for superannuation benefits) – 15% of (₹ 2,50,000 + ₹ 50,000)	45,000
Value of furniture - 10% of ₹ 3,00,000 for 10 months	25,000
Motor car - ₹ 2700 x 10 (As per perquisite rules)	27,000
Sweeper (Actual cost to company) – ₹ 1500 x 10	15,000
Watchman (Actual cost to company) – ₹ 1500 x 10	15,000
Educational facility for 2 children (assumed that the cost of education per child does not exceed ₹ 1,000 p.m.)	NIL
Interest free loan for purchase of house - 10% p.a. on ₹ 5 Lacs for 6 months	25,000
Interest free loan for purchase of computer - 16.50% p.a. of ₹ 50,000 for 3 months	2,063
Income from salary	**5,54,063**

Note: *Motor car owned by employer used partly for official purpose and partly for personal purpose by the employee is taxable as perquisite. The cubic capacity of the engine is less than 1.6 litres. The perquisite value including driver salary is ₹ 1800 + ₹ 900 per month. The perquisite value is therefore ₹ 27,000 (₹ 2,700 x 10).*

Exercise

1. *Define "Salary" and discuss the basis of charge of salary.*
2. *Distinguish between foregoing of salary and surrender of salary.*
3. *Write short notes on -*
   a) *Profits in lieu of salary*
   b) *Specified employees*
4. *Is retrenchment compensation received by workmen taxable under the Act? If yes, to what extent is it taxable?*
5. *When is provision of medical facilities or assistance by an employer not treated as a perquisite in the hands of the employee? Discuss.*
6. *Discuss whether the tax paid by the employer, on the non-monetary perquisites provided to its employees, constitutes an income in the hands of the employees.*

5

Income from House Property

Question 1

People Housing Ltd. is engaged in the business of constructing residential and commercial properties. One of the building properties was included in the closing stock in the Balance Sheet. The said building was let out for a monthly rent as suitable buyers could not be found. All other buildings had been sold by the company. State with reasons whether the income by way of rent from the unsold property is assessable as income from business or income from house property.

What would be your answer if the main objective of the company was to hold properties and earn income by letting out of these properties?

Answer

Under section 22, the charging section for "Income from house property", the only exception provided is the income derived from property used/occupied by the assessee for his own business. Therefore, income derived from letting out of house property will always be taxable under the head "Income from house property". It will be so taxable even if property is held by the assessee as stock-in-trade of his business.

(a) 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".

> ***Note** – The Gujarat High Court has, however, expressed an alternate view in CIT v. Neha Builders P. Ltd. (2008) 296 ITR 661, where it was held that in the case of an assessee engaged in construction and sale of buildings, the same would constitute stock-in-trade of the assessee and any income derived from stock would be assessable as business income.*

(b) The Supreme Court, in *Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673,* held that where holding of properties and earning income by letting out of these properties is the main objective of the company as laid out in its Memorandum of

Association and the entire income of the company as per its return of income accepted by the Assessing Officer comprises of income from letting out of such properties, such income would be assessable as “Profits and gains of business or profession.”

Question 2

Ankit Private Limited has, in its return of income, claimed a sum of ₹ 40,000 as a deduction on account of payments for stamp duty and registration charges from the income shown under the head "Income from house property". The Assessing Officer disallowed the claim of the assessee company in the assessment order passed under section 143(3). Examine the correctness of the action of the Assessing Officer.

Answer

In the determination of annual value of house property under section 23, what is to be deducted is provided in the section itself. For example, where the property is let-out, the municipal taxes paid by the owner are allowed to be deducted in the determination of the net annual value of the property. Once the net annual value is determined, the deductions which are admissible are specified in section 24, namely statutory deduction @30% of net annual value and deduction in respect of interest on borrowed capital taken for the purpose of acquiring, constructing, renewing or repairing the house property. Thus, the amount spent by the assessee towards stamp duty for drawing up the lease deed and the registration cannot be allowed as deduction in determining annual value of the property.

Therefore, the action of the Assessing Officer in disallowing the deduction in respect of stamp duty and registration charges, is correct.

Question 3

Vishnu has two houses, both of which are self-occupied. The particulars of the houses for the P.Y. 2016-17 are as under:

Particulars	*House I*	*House II*
Municipal valuation p.a.	*₹ 4,00,000*	*₹ 6,00,000*
Fair rent p.a.	*₹ 3,00,000*	*₹ 7,00,000*
Standard rent p.a.	*₹ 3,60,000*	*₹ 7,40,000*
Date of completion	*31.3.2007*	*31.3.2010*
Municipal taxes paid during the year	*10%*	*9%*
Interest on money borrowed for construction of house	*₹ 1,75,000*	*₹ 2,50,000*

Compute Vishnu’s income from house property for A.Y.2017-18 and suggest which house should be opted by Vishnu to be assessed as self-occupied so that his tax liability is minimum.

Answer

Computation of Income from house property of Vishnu for the A.Y. 2017-18

Let us first calculate the income from each house property assuming that they are deemed to be let out.

Particulars	₹	
	House I	House II
Gross Annual Value (GAV)		
Expected Rent (ER) is the GAV of house property		
ER = Higher of Municipal value and fair rent, but restricted to standard rent	3,60,000	7,00,000
Less: Municipal taxes (paid by the owner during the previous year as a percentage of Municipal Valuation)	40,000	54,000
Net Annual Value (NAV)	**3,20,000**	**6,46,000**
***Less:* Deductions under section 24**		
(a) 30% of NAV	96,000	1,93,800
(b) Interest on borrowed capital	1,75,000	2,50,000
Income from house property	**49,000**	**2,02,200**

OPTION 1 (House I – self-occupied and House II – deemed to be let out)

If House I is opted to be self-occupied, the income from house property shall be –

Particulars	₹
House I (Self-occupied) [representing interest on borrowed capital, assuming the construction of the house was completed within the prescribed time from the end of the financial year in which the capital was borrowed]	(1,75,000)
House II (Deemed to be let-out)	2,02,200
Income from house property	**27,200**

OPTION 2 (House I – deemed to be let out and House II – self-occupied)

If House II is opted to be self-occupied, the income from house property shall be –

Particulars	₹
House I (Deemed to be let-out)	49,000
House II (Self-occupied) [Loss representing interest on borrowed capital restricted to ₹ 2,00,000]	(2,00,000)
Income from house property	**(1,51,000)**

Since Option 2 is more beneficial, Vishnu should opt to treat House II as self-occupied and House I as deemed to be let out. His loss from house property would be ₹ 1,51,000 for the A.Y. 2017-18. This loss can be carried forward to the next year for set-off against income from house property of that year. It can be carried forward up to a maximum of 8 years.

Question 4

In the following cases, state the head of income under which the receipt is to be assessed-

(a) Anirudh let out his property to Abhinav. Abhinav sublets it. How is sub-letting receipt to be assessed in the hands of Abhinav?

(b) Anish has built a house on a leasehold land. He has let-out the above property and has considered the rent from such property under the head "Income from other sources" and deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 50% of receipts.

Answer

(a) Sub-letting receipt is to be assessed as "Income from Other Sources" or as "Profits and gains of business or profession" in hands of Mr. Abhinav, depending upon the facts and circumstances of each case. It is not assessable as income from house property, since one of the conditions for assessing an income under this head is that the assessee should be the owner of the property i.e. owner of the building and the land appurtenant thereto. In this case, since Abhinav is not the owner of the house property, sub-letting receipt cannot be assessed under the head "Income from house property".

(b) Since Anish is the owner of the property (building), in this case, the receipt would be assessable as "Income from house property". The ownership of land is not a pre-requisite for assessment of income under this head. 30% of Net Annual Value is allowed as a deduction under section 24.

Question 5

Rajesh owns a house in Hyderabad. During the previous year 2016-17, 3/4th portion of the house was self-occupied and 1/4th portion was let out for residential purposes at a rent of ₹ 12,000 p.m. The tenant vacated the property on February 28th 2017. The property was vacant during March, 2017. Rent for the months of January 2017 and February 2017 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied.

Municipal value of the property is ₹ 4,00,000 p.a., fair rent is ₹ 4,40,000 p.a. and standard rent is ₹ 4,80,000. He paid municipal taxes @10% of municipal value during the year. A loan of ₹ 30,00,000 was taken by him during the year 2009 for acquiring the property. Interest on loan paid during the previous year 2016-17 was ₹ 1,48,000. Compute Rajesh's income from house property for the A.Y. 2017-18.

Answer

There are two units of the house. Unit I with 3/4th area is used by Rajesh for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be nil. Unit 2 with 1/4th area is let-out during the previous year and its annual value has to be determined as per section 23(1).

Computation of Income from house property of Mr. Rajesh for the A.Y. 2017-18

Particulars	₹	
Unit I (3/4th area – self-occupied)		
Annual Value		Nil
Less: Deduction under section 24(b) 3/4th of ₹ 1,48,000		1,11,000
Income from Unit I (self-occupied)		**-1,11,000**
Unit II (1/4th area – let out)		
Computation of GAV		
Step 1 – Computation of Expected Rent (ER)		
ER = Higher of municipal valuation (MV) and fair rent (FR), but restricted to standard rent (SR). However, in this case, standard rent of ₹ 1,20,000 (1/4th of ₹ 4,80,000) is more than the higher of MV of ₹ 1,00,000 (1/4th of ₹ 4,00,000) and FR of ₹ 1,10,000 (1/4th of ₹ 4,40,000). Hence the higher of MV and FR is the ER. In this case, it is the fair rent.	1,10,000	
Step 2 – Computation of actual rent received/ receivable ₹ 12,000×9 = 1,08,000	1,08,000	
[The property was let-out for 11 months. However, rent for 2 months i.e., January and February, 2017 could not be realized. As per *Explanation to section 23(1)*, actual rent should not include any amount of rent which is not capable of being realized. Therefore, actual rent has been computed for 9 months]		
Step 3 – GAV is the higher of ER and actual rent received/receivable. However, as per section 23(1)(c), where the let-out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ER, then the actual rent received would be the GAV of the property. In this case, the actual rent is lower than the ER owing to vacancy, since had the property not been vacant in March 2017, the actual rent would have been ₹ 1,20,000 (i.e., ₹ 1,08,000 + ₹ 12,000), which is higher than the ER of ₹ 1,10,000. Therefore, in this case, section	1,08,000	

23(1)(c) would apply and the actual rent of ₹ 1,08,000 would be the GAV, since it is lower than the ER owing to vacancy.		
Gross Annual Value(GAV)		**1,08,000**
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion 1/4th of (10% of ₹ 4,00,000) = ₹ 40000/4 = ₹ 10,000		10,000
Net Annual Value(NAV)		**98,000**
Less: Deductions under section 24		
(a) 30% of NAV = 30% of ₹ 98,000	29,400	
(b) Interest paid on borrowed capital (relating to let out portion) [1/4th of ₹ 1,48,000]	37,000	66,400
Income from Unit II (let-out)		**31,600**
Loss under the head "Income from house property" (-1,11,000 + 31,600)		**-79,400**

Question 6

During the financial year 2016-17, Mr. A received a sum of ₹ 1,80,000 (₹ 60,000 p.a.) by way of arrears for the last three years as the Government department (tenant) enhanced the rate of rent with retrospective effect. Will the sum of ₹ 1,80,000 be taxable in the assessment year 2017-18 ? Can it be spread over the last three years?

Answer

As per section 25A, the arrears of rent shall be taxable in the previous year in which such arrears are received. The assessee shall be allowed deduction @ 30% of such amount received. Further, it is not necessary that the assessee should be owner of such house property in the previous year in which such arrears are received.

As the arrear rent of ₹ 1,80,000 is received in the previous year 2016-17, the same is taxable in the A.Y.2017-18. Thus, the net sum of ₹ 1,26,000 (i.e. ₹ 1,80,000 – ₹ 54,000) shall be chargeable to tax under the head "Income from house property".

There is no provision in the Income-tax Act, 1961, enabling the assessee to spread over the arrears of rent over the last three years.

Question 7

P, an individual, borrowed ₹ 20,00,000 for repair of his self-occupied house property and paid interest of ₹ 1,60,000 thereon during the financial year 2016-17. What is the amount of interest allowable as deduction under section 24 for the assessment year 2017-18?

Answer

Section 24(b) provides that where the self-occupied house property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, deduction towards interest payable thereon shall not exceed ₹ 30,000. Therefore, only ₹ 30,000 would be allowed as deduction on account of interest on loan borrowed for repair and reconstruction of self-occupied house property.

The higher limit of ₹ 2,00,000 in respect of interest on loan borrowed on or after 1.4.1999 would be available only where such loan is borrowed for acquisition or construction of self-occupied property and not for repair of such property.

Question 8

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?

Answer

Under section 22, the annual value of a property is chargeable to tax under the head "Income from house property" in the hands of the owner. However, this section specifically excludes property occupied for the purposes of own business or profession of the assessee, the profits of which are chargeable to income-tax. 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 a portion of 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, in this case, the action of the Assessing Officer is not correct.

Question 9

'X', an American national, a resident in India during the financial year 2016-17 owned a building located in New York. The same was on rent @ US $ 12,500 p.m. The Municipal Corporation of New York was paid taxes on such building of US $ 10,000 on 12.2.2017. Besides the above property, he purchased a piece of land at Delhi for construction of a house. The said land was given on rent for running a dairy farm @ ₹ 3,000 p.m. w.e.f. 1.10.2016. The value of one US $ in Indian rupee throughout the year remained at ₹ 63.

'X' wants to know his taxable income for assessment year 2017-18 as per the provisions of the Income-tax Act, 1961.

Answer

For the previous year, Mr. X, an American National, was a resident in India. Accordingly, the income received by him by way of rent of the house property located in USA is subject to tax in India. Municipal taxes so paid in the country where the property is situated are also to be allowed as held in the case of *CIT v. R. Venugopala Reddiar (1965) 58 ITR 439* by the Madras High Court.

The income chargeable to tax will be as under -

Particulars	₹	₹
Income from House Property		
House property located in New York		
Annual rental value being actual rent received of US $ 12,500 p.m. converted into Indian Rupees @ 63	94,50,000	
Less: Municipal taxes paid (US $ 10,000 × 63)	6,30,000	
Net Annual Value (NAV)	88,20,000	
Less: Deduction under section 24 @ 30% of NAV	26,46,000	61,74,000
Income from other sources		
Rental income from the land located at Delhi given on rent for 6 months		18,000
Total income		**61,92,000**

Note: Rent from vacant land is chargeable to tax under the head "Income from other sources".

As the students are not expected to know the provisions of DTAA between India and any foreign country for the purpose of examination, the provisions of DTAA between India and US has not been considered in the above solution.

Question 10

How do you deal with the following issue under the respective provisions of the Income-tax Act, 1961?

The assessee, who was deriving income from "house property", realised a sum of ₹ 52,000 on account of display of advertisement hoardings of various concerns on the roof of the building. He claims that this amount should be considered under the head "House Property" and not under "other sources".

Answer

This question came up for consideration before the Calcutta High Court in *Mukherjee Estate (P) Ltd v. CIT (2000) 244 ITR 1.* It was decided that the assessee let out the roof for advertisement for hoarding and that the income cannot be considered as income from house property as hoardings do not form part of the building. Such income is chargeable under the head "Income from other sources".

Question 11

State the circumstances, when notional income is charged to tax instead of real income under the head "Income from house property".

Answer

The circumstances when notional income is charged to tax instead of real income under the head "Income from house property" are as under -

(i) Where the assessee owns more than one house property for the purpose of self-occupation, the annual value of any one of those properties, at the option of the assessee, will be nil and the other properties are deemed to be let-out properties for which income has to be computed on notional basis by taking the Expected Rent (ER) as the Gross Annual Value (GAV).

(ii) In the case of let-out property, where the ER exceeds the actual rent, the ER is taken as the GAV.

Note – *Expected Rent is the higher of municipal valuation and fair rent, but restricted to standard rent.*

Question 12

Sridhar purchased a residential flat from Devraj in December 2016. However, the deed of conveyance has not been registered in the name of Sridhar till 31.03.2017. Sridhar has let out the flat at a monthly rent of ₹ 25,000 to Mohan.

Sridhar claims that rent received is not chargeable under the head "Income from house property", but the same is chargeable under the head "Income from other sources" and he can claim deduction for expenses on repair and insurance premium on actual basis and also depreciation. Examine the correctness of Sridhar's claim.

Answer

In order to assess income under the head "Income from house property" the assessee must be the owner of the house property. The need for registration of document in favour of a person to enable him to be treated as the owner of the house property for the purpose of section 22, was considered by the Supreme Court in the case of *CIT vs. Poddar Cement Pvt. Ltd. (1997) 226 ITR 625.*

It was held that so long as a person is entitled to receive income from the house property in his own right and not on behalf of someone else, it is not necessary that the sale deed must be registered in favour of the person to treat him as the owner of the property for the purpose of section 22. In such a case, the income derived from the property is chargeable to tax under the head "Income from house property". The fact that registration is not yet complete does not affect the chargeability of such income under the head "Income from house property".

Therefore, the claim of Sridhar that rent should be assessed under the head "Income from other sources" and deduction of various expenses and depreciation should be allowed therefrom is not tenable.

Question 13

A & Co. Ltd., a property developer and builder, disclosed unsold flats as stock in trade in its books of account as well as in wealth tax return. It let out those flats and offered the same as income from house property by claiming statutory deduction under section 24 of the Act. The Assessing Officer disallowed statutory deduction and taxed the same as income from business. Decide the correctness of the action of the Assessing Officer.

Answer

The issue under consideration in this case is whether rental income derived from the let out flats disclosed as stock-in trade in the books of accounts as well as in wealth tax return of A & Co. Ltd., a property dealer, would be taxable under the head "Income from house Property" or "Profits and gains of business or profession".

As per section 22, the annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property".

Therefore, only property occupied by the assessee for the purpose of his own business is excluded from the scope of section 22. As a logical corollary, section 22 does not exclude from its scope, income from property held as stock-in-trade.

The Calcutta High Court, in *Azimganj Estate (P.) Ltd. v. CIT (2013) 352 ITR 82,* observed that the rental income from the unsold flats of a builder shall be taxable as "Income from house property" as provided under section 22 and since it specifically falls under this head, it cannot be taxed under the head "Profit and gains from business or profession". Therefore, the assessee would be entitled to claim statutory deduction of 30% from such rental income as per section 24. The fact that the flats have been claimed as not chargeable to wealth-tax, treating the same as stock-in-trade, will not affect the computation of income under the Income-tax Act, 1961.

Thus, the rental income from the unsold flats of a builder, A & Co. Ltd., in this case, shall be taxable as "Income from house property" as provided under section 22 and since it specifically falls under this head, it cannot be taxed under the head "Profit and gains from business or profession".

A & Co. Ltd. would be entitled to claim statutory deduction of 30% from such rental income as per section 24.

Therefore, the action of the Assessing Officer in this case denying the statutory deduction and treating the income from let-out flats as business income is not correct.

Note – *In CIT v. Neha Builders Pvt. Ltd. (2008) 296 ITR 661 (Guj.), it was held that rental income from property held as stock-in-trade would be taxable as business income and not income from house property.*

Exercise

1. *Discuss the following issues relating to Income from house property -*

   (i) *Income earned by residents from house properties situated in foreign countries.*

   (ii) *Properties which are used for agricultural purposes.*

2. *Discuss the provisions regarding taxability of Arrears of rent and Unrealised rent*

3. *How is the income from house property of a house, which is self-occupied for part of the year and let out for part of the year, computed?*

4. *In certain cases, persons who are not legal owners of the house property are deemed to be owners for the purpose of charge of income-tax. Discuss the correctness or otherwise of the above statement.*

5. *Discuss the tax treatment of income from co-owned property.*

6. *Arvind commenced construction of a residential house intended exclusively for his residence, on 1.11.2015. He raised a loan of ₹ 5,00,000 at 16% p.a. for the purpose of construction on 1.11.2015. Finding that there was an over-run in the cost of construction he raised a further loan of ₹ 8,00,000 at the same rate of interest on 1.10.2016. What is the interest allowable under section 24 for A.Y.2017-18, assuming that the construction was completed on 31.3.2016?*

7. *Ram owned a house property at Chennai which was occupied by him for the purpose of his residence. He was transferred to Mumbai in June, 2016 and therefore, he let out the property w.e.f. 1.7.2016 on a monthly rent of ₹ 8,000. The corporation tax payable in respect of the property was ₹ 2,000 of which 50% was paid by him before 31.3.2017. Interest on money borrowed for the construction of the property amounted to ₹ 12,000. Compute the income from house property for the A.Y.2017-18.*

8. *X Ltd. had let out the house property owned by it to the employees of its sister concern, Y Ltd. Under what head of income should the income from the house property of X Ltd., occupied by the employees of its sister concern Y Ltd., be assessed? Can X Ltd. claim that such income is not chargeable under the head "Income from house property", on the ground that the property has been occupied for the purpose of its business or profession?*

Answers

6. ₹ 1,50,667

7. ₹ 54,500 (assuming the fair rent to be ₹ 8,000 per month)

8. These questions have been answered by the Madras High Court in *CIT vs. T.V. Sundaram Iyengar & Sons Ltd. (2005) 145 Taxman 380 / (2004) 271 ITR 79*. The High Court observed that in order to claim exemption in respect of income from house property under section 22, the assessee must satisfy two conditions, namely –

(1) the property or portion thereof must be occupied by the assessee for the purposes of his business or profession; and

(2) the profits of such business should be chargeable to income-tax.

The issue under consideration is that in order to avail the exemption under section 22, is it necessary that the property must be –

(i) in direct occupation of the assessee-company, and

(ii) used as such for transaction of the assessee's business or profession.

The High Court observed that the term 'occupy' appearing in section 22, when judicially interpreted, means occupation, directly by the assessee himself or through an employee or agent, subservient and necessary for the performance of the duties in connection with the business of the company. The assessee had let out the properties in question to the employees of the sister concern, who was separate and independent assessees by themselves, which made a vast difference from letting out of properties to the employees of the assessee itself. Therefore, the occupation of the properties in question by the employees of the sister concern could not be construed as an occupation by the employees of the assessee itself, in the absence of any specific provision in law to that effect.

Therefore, the income from the property let out to the employees of the sister concern Y Ltd. should be treated as income from house property of X Ltd. under section 22.

6

Profits and Gains of Business or Profession

Question 1

Examine critically the following cases in the context of provisions contained in the Income-tax Act, 1961 relevant for Assessment Year 2017-18. Support the answers with relevant case laws and workings.

(a) *Mr. Janak is proprietor of M/s. Yash Texnit which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 20 different machinery items as at 31-03-2016. One of the machineries used for packing had become obsolete and was discarded by Mr. Janak in July' 16.*

Assessee filed its return for A.Y. 2017-18 claiming total depreciation of ₹ 40 lacs which includes ₹ 4 lacs being the depreciation claimed on the machinery item discarded by Mr. Janak. The A.O. disallowed the claim of depreciation of ₹ 4 lacs during the course of scrutiny assessment.

Comment on the validity of action taken by A.O.

(b) *X. Ltd. issued debentures in the previous year 2016-17, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of ₹ 60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2016-17. Examine the correctness of the action of Assessing Officer.*

Answer

(a) The issue under consideration is whether disallowance of depreciation made by the Assessing Officer with regard to the discarded asset, in arriving at the written down value of the block of assets, is justified.

One of the conditions for claim of depreciation under section 32 is that the eligible asset must have been put to use for the purpose of business or profession.

The other aspect to considered is whether merely discarding an obsolete machinery, which is physically available, will attract the expression "moneys payable" appearing in section 43(6), so as to deduct its value from the written down value of the block.

The facts in the present case are similar to facts in the case of *CIT v. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297*, wherein the Delhi High Court observed that the expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years.

The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business.

For the purpose of section 43(6), "moneys payable" means the sale price, in case of sale, or the insurance, salvage or compensation moneys payable in respect of the asset. In this case, the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence, there is no "moneys payable" in this case, which alone is deductible while computing the WDV of the block to which it belongs.

Applying the rationale of the above case, the action of the Assessing Officer in disallowing ₹ 4 lakhs, being the depreciation claim attributable to discarded machinery, on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

(b) The issue under consideration is whether, in a case where debentures are issued with maturity at the end of five years, and the debenture holders are given an option of upfront payment of interest in the first year itself, can the entire upfront interest paid be claimed as deduction by the company in the first year or should the same be deferred over a period of five years; and would the treatment of such interest as deferred revenue expenditure in the books of account have any impact on the tax treatment.

The facts of the case are similar to the facts in *Taparia Tools Ltd. v. JCIT (2015) 372 ITR 605*, wherein the above issue came up before the Supreme Court. In that case, it was observed that under section 36(1)(iii), the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

The moment the option for upfront payment was exercised by the subscriber, the liability of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

As per the rationale of the Supreme Court ruling in *Taparia Tools Ltd.'s* case, when the deduction of entire upfront payment of interest is allowable as per the Income-tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2016-17 to one-fifth of the upfront interest paid is **not** correct. The company is eligible to claim the entire amount of interest paid upfront as deduction under section 36(1)(iii) in the P.Y.2016-17.

Question 2

Details given below relate to investments made in new plant & machinery by companies:

Company	***Value of new plant and machinery***	***Previous Year of***	
		acquisition	***installation***
	₹ in crores		
ABC Ltd.	*85*	*2015-16*	*2016-17*
MNO Ltd.	*20*	*2016-17*	*2016-17*
RST Ltd.	*70*	*2016-17*	*2017-18*

Compute deduction under section 32AC on the assumption that all the acquisitions are eligible assets and give reasons in brief for the amount computed. Also, state the year in which the deduction would be allowable in each case.

Answer

Deduction under section 32AC

Company	**Investment in new plant and machinery (Rs. in crores)**	**Deduction under section 32AC**
ABC Ltd.	85	Deduction@15% under section 32AC would be available in the year of installation i.e. P.Y.2016-17, even though the new plant and machinery was acquired in the P.Y.2015-16. Since the eligible plant and machinery were installed in the financial year 2016-17, the assessee is eligible for deduction in the assessment year 2017-18. The amount eligible for deduction under section 32AC for the A.Y.2017-18 would be **₹ 12.75 crores**.
MNO Ltd.	20	In this case, both the acquisition and the installation is in the same previous year i.e., P.Y.2016-17. However, MNO Ltd. would not be eligible for deduction under section 32AC since the

		investment in new plant and machinery in P.Y.2016-17 is less than ₹ 25 crores.
RST Ltd	70	In this case, even though the investment in new plant and machinery exceeds ₹ 25 crores in the P.Y.2016-17, being the year of acquisition, no deduction under section 32AC would be allowable either in the year of acquisition or in the year of installation, since the installation is after 31.3.2017.

Question 3

X & Co., a partnership firm consisting of three partners, enhanced working partner salary from ₹ 25,000 per month for each partner to ₹ 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 @ ₹ 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.

Answer

The issue under consideration is whether remuneration paid to working partners as per the partnership deed can be considered as unreasonable and excessive for attracting disallowance under section 40A(2)(a) of the Income-tax Act, 1961 even though the same is within the limit prescribed under section 40(b)(v).

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.

The Assessing Officer is only required to ensure that the remuneration is paid to the working partners mentioned in the partnership deed, the terms and conditions of the partnership deed provide for payment of such remuneration to the working partners and the remuneration is within the limits prescribed under section 40(b)(v). If these conditions are complied with, then the Assessing Officer cannot disallow any part of the remuneration on the ground that it is excessive.

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).

The action of the Assessing Officer in this case is, therefore, **not correct**.

Question 4

Compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 and any other benefit available in respect of the following items of Plant and Machinery purchased by PQR Textile Ltd., which is engaged in the manufacture of textile fabrics, for the year ended 31-3-2017:

	(₹ In crores)
New machinery installed on 1-5-2016	*84*
New Windmill purchased and installed on 18-6-2016.	*22*
Items purchased after 30th November 2016:	
Lorries for transporting goods to sales depots	*3*
Fork-lift-trucks, used inside factory	*4*
Computers installed in office premises	*1*
Computers installed in factory	*2*
New imported machinery	*12*

The new imported machinery arrived at Chennai port on 30-03-2017 and was installed on 3-4-2017. All other items were installed during the year ended 31-3-2017.

The company was newly started during the year.

Also, compute the WDV of the various blocks of assets as on 1.4.2017.

Will your answer be different if the above assessee is a partnership firm?

Answer

Computation of depreciation allowance under section 32 for the A.Y. 2017-18

	Particulars	**Normal Depreciation [u/s 32(1)(ii)]**	**Additional Depreciation [u/s 32(1)(iia)]**
		(₹ in crores)	
(A)	**Plant and Machinery (15% block) (Put to use for 180 days or more)**		
	- New machinery installed on 01.05.2016	84.00	84.00
	Normal Depreciation@15% & additional deprecation @20%	**12.60**	**16.80**

(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)		
- Lorries for transporting goods to depots	3.00	-
- Fork-lift trucks, used inside a factory	4.00	4.00
	7.00	4.00
Normal Depreciation @ 7.5% & additional depreciation @10%	**0.53**	**0.40**
(C) Plant and Machinery (60% block) (Put to use for less than 180 days, hence depreciation restricted to 30%, i.e., 50% of 60%)		
- Computers installed in office premises	1.00	-
- Computers installed in factory	2.00	2.00
	3.00	2.00
Normal depreciation @30% & additional depreciation @10%	**0.90**	**0.20**
(D) Plant and Machinery (80% block) (Put to use for 180 days or more) *(See Note 1)*		
- New windmill purchased and installed on 18.06.2016	22.00	22.00
Normal Depreciation@80% & additional depreciation @20%	**17.60**	**4.40**
Total depreciation and additional depreciation		
- Plant and Machinery (15% block) (A +B)	13.13	17.20
- Plant and Machinery (60% block) (C)	0.90	0.20
- Plant and Machinery (80% block) (D)	17.60	4.40
Depreciation available under section 32 = ₹ 53.43 crores		

Computation of Written Down Value (WDV) as on 01.04.2017

Particulars		Plant & Machinery		
		15%	60%	80%
		(₹ in crores)		
WDV as on 01.04.2016 (The company was started during the year – as given in question)		Nil	Nil	
Add: Plant and Machinery acquired during the year				
- New Machinery installed on 01.05.2016	84.00			
- Lorries for transporting goods to sales depots	3.00			
- Fork-lift trucks, used inside factory	4.00			

- New imported machinery	12.00	103.00	-	
- New Windmill purchased and installed on 18.6. 2016		-	-	22.00
- Computers installed in office premises		-	1.00	-
- Computers installed in factory		-	2.00	-
		103.00	3.00	22.00
Less: Asset sold during the year		Nil	Nil	Nil
WDV as on 31.3.2017 (before charging depreciation)		103.00	3.00	22.00
Less: Depreciation for the P.Y.2016-17				
- Normal depreciation		13.13	0.90	17.60
- Additional depreciation		17.20	0.20	4.40
WDV as on 1.4.2017		**72.67**	**1.90**	**0.00**

Computation of deduction under section 32AC for the A.Y.2017-2018

(See Notes 2 to 6 below)

Particulars	(₹ in crore)
Plant and Machinery acquired and installed during the previous year	
- New Machinery installed on 1.05.2016	84.00
- New Windmill purchased and installed on 18.06.2016	-
- Fork-lift trucks, used inside factory	4.00
- Computers installed in factory	2.00
	90.00
15% of ₹ 90 crore, being aggregate investment in new plant and machinery acquired and installed during the P.Y.2016-17	13.50

If the assessee is a partnership firm instead of a company

Yes, the answer would be different in respect of deduction under section 32AC, since this deduction is available only to an assessee, being a company engaged in the business of manufacture or production of any article or thing. Therefore, a partnership firm would not be eligible for deduction under section 32AC.

However, depreciation and additional depreciation computed under section 32(1)(ii) and 32(1)(iia), respectively, and the written down of the block of assets would remain the same, even if the assesee is a firm.

Notes:

(1) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014 would be eligible for depreciation@80%.

(2) A company would be entitled for deduction under section 32AC if the investment in new plant and machinery acquired and installed during the previous year exceeds Rs.25 crores. The deduction under section 32AC would be in addition to the depreciation allowable under section 32 for that year. However, such deduction would not go to reduce the written down value of plant and machinery.

(3) New imported machinery was not installed during the previous year 2016-17. Hence, it would not be eligible for deduction under section 32AC and additional depreciation for A.Y. 2017-18. It would also not be eligible for normal depreciation for A.Y 2017-18, since it was not put to use in the P.Y.2016-17 being the year of acquisition.

(4) It may be noted that investment in the following plant and machinery would neither be eligible for deduction under section 32AC nor for additional depreciation under section 32(1)(iia):

 (a) Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and

 (b) Computers installed in office premises.

(5) As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a "vehicle" excludes, *inter alia*, a vehicle of special type adopted for use only in a factory or in any enclosed premises. Therefore, fork-lift trucks used inside the factory would not fall within the definition of "vehicle". Hence, it is eligible for additional deprecation under section 32(1)(iia) and deduction under section 32AC.

(6) The deduction under section 32AC would not be allowed in respect of the windmill since the whole of the actual cost of the windmill is allowed as deduction by way of depreciation @ 80% and additional depreciation @ 20% [Section 32AC(4)(v)].

Note *– The above solution has been worked out assuming that PQR Textiles Ltd. has not exercised the option to be taxed at a concessional rate of 25% under section 115BA. If the company has exercised this option, then, it would not be eligible for additional depreciation and deduction under section 32AC. Further, normal depreciation on computers and windmills would also be restricted to 40%.*

Question 5

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) Amount received towards power subsidy with a stipulation that the same is to be adjusted in the electricity bills.

(ii) Donations received by a person in the course of carrying on vocation, from his followers.

(iii) 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.

(iv) 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.

(v) Depreciation on the "decoders" given on loan to the cable operators but owned by the assessee who is engaged in the business of distributing satellite channels.

Answer

Taxability of the following receipts/income while computing income under the head "Profits and gains of business or profession"

(i) As per section 2(24)(xviii) assistance in the form of subsidy or grant or cash incentive by the Central Government or a State Government or any authority or body or agency in cash or kind is chargeable to tax as income. Also, ICDS VII seeks admission of such grant as income. Government grants should not be recognized until there is reasonable assurance that (i) the person shall comply with the conditions attached to them, and (ii) the grants shall be received. However, recognition of such grant shall not be postponed beyond the date of actual receipt. Since power subsidy has been received by the assessee, it is revenue in nature and chargeable to tax in A.Y. 2017-18.

(ii) 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.

(iii) 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*.

(iv) 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.

(v) Loan of "decoders" to cable operators is in the normal course of the assessee's business of distribution of satellite channels, and hence the same can be treated as use of asset for business purposes. Since the assessee is the owner of decoders used for business purposes, he is entitled to depreciation under section 32. The Delhi High Court, in *CIT vs. Turner International India (P) Ltd. (2008) 297 ITR 373*, has confirmed this view.

Question 6

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.

Answer

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 or profession and no deduction or allowance shall be given in respect of such expenditure.

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.

The demand as well as payment of such referral fee is bad in law. It is not a fair practice and is opposed to public policy. 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 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. The fact that tax has been deducted under section 194H would not make any difference as regards the eligibility for deduction.

Question 7

(A) Explain in brief, the treatment as to their taxability and/or allowability, under the provisions of the Income-tax Act, 1961, for the assessment year 2017-18, in the following cases:

(i) S Ltd. receives a sum of ₹ 10 lakhs from K Ltd. on 3rd January, 2017 for agreeing not to carry on any business relating to computer software in India for the next three years.

(ii) A company had an inventory of closing stock on 31.03.2017, the cost of manufacturing of which was ₹ 50 lakhs and the Excise duty payable was ₹ 6 lakhs. Since the Excise duty was eligible for deduction only on actual payment, the company

valued the closing stock at ₹ 50 lakhs only. The company paid duty amounting to ₹ 4 lakhs on such stock on clearances upto the date of filing of its return of income.

(iii) P Ltd. paid dollars equivalent to ₹ 50 lakhs as sales commission for the year ended 31.03.2017, without deducting tax at source, to Mr. Rodrigues, a citizen of UK and non-resident who acted as agent for booking orders, from various customers who are outside India.

(B) Can the following transactions be covered under section 43B for disallowance?

(i) A bank guarantee given by a company towards disputed tax liabilities.

(ii) Interest payable to Sales Tax Department but not paid before the due date specified in section 139(1).

Answer

(A) (i) As per section 28(va), any sum received under an agreement for not carrying out any activity in relation to any business / profession (i.e., non-compete fee) is chargeable to income-tax under the head "Profits and gains of business or profession".

Accordingly, ₹ 10 lakhs received by S Ltd. from K Ltd. for agreeing not to carry on any business relating to computer software in India for the next three years is chargeable to income-tax under the head "Profits and gains of business or profession".

The amount shall be allowed as deduction in the hands of K Ltd. provided tax has been deducted at source under section 194J on the payment so made to S Ltd. If tax is not deducted at source, 30% of the expenditure shall be disallowed under section 40(a)(ia).

(ii) Excise duty liability arises at the time of manufacture of goods and not on clearances. Therefore, it has to be included in the value of closing stock as per section 145A. Therefore, the closing stock has to be valued at ₹ 56 lakhs (i.e., including excise duty payable of ₹ 6 lakhs).

As per section 43B, deduction can be claimed for ₹ 4 lakhs, being the excise duty paid on or before the "due date" of filing the return under section 139(1).

(iii) A foreign agent of an Indian exporter operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for booking orders by non-resident who remains outside India is not subject to tax in India, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India even though tax has not been deducted at source. Thus, the amount of ₹ 50 lakhs remitted to

Mr. Rodrigues outside India in foreign currency towards commission would not attract disallowance under section 40(a)(i) for non-deduction of tax at source.

(B) (i) For claiming deduction of any expense enumerated under section 43B, the requirement is, the actual payment and not deemed payment. Furnishing of bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee *[CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)]*

(ii) Interest payable to Sales tax department is 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)]*

Question 8

"Shanaz Ltd" engaged in manufacturing of different products was asked by the Central Excise Department to pay an amount of ₹ 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. The Assessing Officer issued a show cause on the basis of the decision of the High Court to tax the benefit derived by the company in A.Y. 2017-18. Discuss the correctness of the action of Assessing Officer, if the assessee company has not received the refund from Central Excise Department pursuant to the High Court order.

Answer

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.

The taxability under section 41(1), would, however, arise only if the assessee has obtained refund pursuant to the decision of the Court. In this case, since Shanaz Ltd has not received the refund, the deeming provisions of section 41(1) would not be attracted merely due to the reason that the High Court has held that excise duty is not payable by the company *[Union of India v. J.K. Synthetics Ltd (1993) 199 ITR 14 (SC)].*

***Note** – If, the assessee had received refund of the excise duty, the deeming provision in section 41(1) would come into play and it is not necessary that the Revenue should await the verdict of the higher Court. If the higher Court upholds the levy at a later date, the assessee has the remedy to get back the relief.*

Therefore, if the excise duty has been refunded to the assessee pursuant to the decision of the High Court, the same would be subject to tax by virtue of section 41(1) and it is not necessary that the Revenue should await the verdict of the Supreme Court.

Question 9

"Rameshwarm" after purchase put to use on 15-12-2014 a machine worth ₹ 3,00,000 which is eligible for depreciation @ 15% under the Act. He sold this machine to "Ganesham" on 1-1- 2016 for ₹ 3,20,000 (FMV on that date was ₹ 2,50,000), who after having used the machine for his business purposes again sold it back to "Rameshwarm" on 15-11-2016 for ₹ 3,10,000.

Compute the amount of allowable depreciation and of chargeable capital gain, if any, for assessment years 2015-16 to 2017-18 assuming that this was the only machine in the block of asset held by both "Rameshwarm" and "Ganesham". Ignore additional depreciation

Answer

Computation of allowable depreciation/ chargeable capital gains

In case of Rameshwarm

	₹
Assessment year 2015-16 (P.Y. 2014-15)	
WDV as on 01-04- 2014	Nil
Addition during the year on 15-12- 2014	3,00,000
	3,00,000
Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	22,500
WDV as on 01-04-2015	2,77,500
Assessment year 2016-17 (P.Y.2015-16)	
Actual Sale consideration – 01.01.2016	3,20,000
Less: WDV as on 01-04-2015	2,77,500
Short-term capital gains chargeable to tax under section 50	42,500
Assessment year 2017-18 (P.Y.2016-17)	
WDV as on 01-04-2016	Nil
Addition during the year on 15-11-2016 *[See Note 1]*	2,77,500
	2,77,500

Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	20,813
WDV as on 01-04-2017	2,56,687

In case of Ganesham

	₹
Assessment year 2016-17 (P.Y.2015-16)	
WDV as on 01-04-2015	Nil
Addition during the year on 01-01-2016 [See Note 2]	2,50,000
	2,50,000
Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	18,750
WDV as on 01-04-2016	2,31,250
Assessment year 2017-18(P.Y.2016-17)	
Actual Sale consideration – 15.11.2016	3,10,000
Less: WDV as on 01-04-2016	2,31,250
Short-term capital gains chargeable under section 50	78,750

Notes:

1.	As per *Explanation 4* to section 43(1), where an asset which had once belonged to the assessee and had been used by him for the purpose of his business and thereafter, ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be lower of the following: (a) Actual cost when he first acquired the asset *minus* the depreciation actually allowable to him till the date of transfer (i.e., ₹ 2,77,500, in this case); or (b) Actual price for which it is re-acquired (i.e., ₹ 3,10,000). Therefore, in this case, the actual cost of machinery reacquired by Rameshwarm would be ₹ 2,77,500, being the lower of the two amounts given above.
2.	As per *Explanation 3* to section 43(1), where the assets were at any time, before the date of acquisition by the assessee, used by any other person for the purposes of business or profession and the Assessing Officer is satisfied that the main purpose of the transfer of such asset was the reduction of his liability (by claiming excess depreciation with reference to enhanced cost), the actual cost to the assessee shall be such an amount as determined by the Assessing Officer, with the previous approval of the Joint Commissioner. Consequently, the cost of machinery in the hands of Ganesham would be ₹ 2,50,000, assuming that the fair market value given in the question is the amount determined by the Assessing Officer, with the previous approval of the Joint Commissioner.

Question 10

(a) The partnership deed of a firm does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration as follows:

In case the book profits of the firm are up to ₹ 3 lakhs, then the partners would be entitled to remuneration up to ₹ 1.50 lakhs or 90% of book profits, whichever is more. In respect of balance book profits, it is 60%. "Book profits" shall be computed as defined in section 40(b) of the Income-tax Act, 1961. In case there is a 'loss' in a particular year, the partners shall not be entitled to any remuneration. Remuneration payable to the working partners should be credited to the respective accounts at the time of closing of the accounting year and the working partners shall be entitled to equal remuneration.

Can the firm claim deduction in respect of remuneration paid to the working partners?

(b) Y. Ltd. was amalgamated with X. Ltd. in accordance with a scheme of amalgamation. Assets and liabilities were transferred and vested with X. Ltd. X. Ltd. is of the view that excess consideration paid by it over the value of net assets acquired from Y. Ltd. should be considered as goodwill arising on amalgamation. X. Ltd. claimed depreciation on such goodwill, but the claim was rejected by the Assessing Officer on the ground that goodwill is not an asset falling under Explanation 3 to section 32(1) of the Income-tax Act, 1961. Is the action of the Assessing Officer valid?

Answer

(a) As per section 40(b), payment of remuneration to a working partner which is authorized by and is in accordance with the terms of the partnership deed is allowable as a deduction to the extent it does not exceed the limits specified in section 40(b)(v).

The issue under consideration is whether, in a case where the partnership deed does not specify the amount of remuneration payable to each partner, but lays down the manner of fixing the remuneration, can payment of such remuneration be allowed as deduction?.

In this regard, the CBDT had, vide *Circular No. 739 dated 25.3.1996*, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

The High Court, in *CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP),* has held that where the manner of fixing the remuneration of the working partners is specified in the partnership deed, the assessee-firm would be entitled to deduct the remuneration paid to such partners, subject to the limits specified under section 40(b)(v).

Therefore, in this case, since the partnership deed lays down the manner of quantifying the remuneration payable to working partners, the firm is entitled to deduction subject to the limits specified in section 40(b)(v).

(b) The issue under consideration is whether X Ltd. can claim depreciation on the excess consideration paid by it over the value of net assets acquired from Y Ltd. in a scheme of amalgamation, by treating the same as goodwill, and considering it as an intangible asset within the meaning of *Explanation 3* to section 32(1).

This issue came up before the Supreme Court, in *CIT v. Smifs Securities Ltd. (2012) 348 ITR 302*, wherein it was observed that *Explanation 3(b)* to section 32(1) states that the expression 'asset' shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licences, franchises or 'any other business or commercial rights of similar nature'.

A reading of the words 'any other business or commercial rights of similar nature' in *Explanation 3* indicates that "goodwill" would fall under the said expression, applying the principle of *ejusdem generis*. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased.

Therefore, it was held that the excess consideration paid by X Ltd. over the value of net assets acquired from Y Ltd. in the scheme of amalgamation constitutes goodwill, which is an intangible asset under *Explanation 3(b)* to section 32(1), thereby qualifying for depreciation under that section.

The action of the Assessing Officer in rejecting the claim of depreciation made by X Ltd. is, therefore, not valid.

Question 11

XYZ Limited acquired a machine on 1st April,2016 for ₹ 10 crores by availing 70% loan facility from a bank. The machine was put to regular use from 1st February, 2017. Interest on loan is charged at 12% per annum.

Advise XYZ Limited on the treatment of interest payment made on this loan and depreciation allowable for A.Y. 2017-18 (assume that this machine is the only machine in the said block of assets).

Answer

(i) **Interest on term loan for purchase of machinery:** As per section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for a period beginning from the date of borrowal of loan for acquiring the asset till the date on which such asset is first put to use is not allowable as deduction but has to be captialised by adding the same to the cost of the asset. Therefore, interest@12% p.a. for a period of 10 months from 1st April, 2016 to 31st January, 2017 on ₹ 7 crores, being the amount of loan, is to be capitalized.

	₹
Cost of machinery	10,00,00,000
Add: Interest [12% × 10/12 × ₹ 7,00,00,000]	70,00,000
Actual Cost of machinery	**10,70,00,000**
Interest @12% for two months (February, 2017 & March, 2017) after the asset is put to use is allowable as deduction under section 36(1)(iii) [12% × 2/12 × ₹ 7,00,00,000]	**14,00,000**

(ii) **Depreciation**

	₹
Since the machinery is put to use for less than 180 days in the previous year 2016-17, the depreciation would be restricted to 50% of the amount calculated at the prescribed percentage of 15%.	
Therefore, depreciation = 50% ×[15% × ₹ 10,70,00,000]	80,25,000
Likewise, the additional depreciation would also be restricted to 50% of the amount calculated at the prescribed percentage of 20%, assuming that XYZ Ltd. is engaged in the manufacture or production of any article or thing and that the machinery acquired is a new machinery.	
Therefore, additional depreciation= 50% × [20% × ₹ 10,70,00,000]	1,07,00,000
	1,87,25,000

***Note**: The Company shall not be entitled for investment allowance under section 32AC since the investment in plant and machinery does not exceed ₹ 25 crores.*

ICDS IX relating to 'borrowing costs' in respect of assets also mandates capitalization from the date of borrowing and up to the date such asset is first put to use.

Question 12

KLM Limited has gone for pension scheme referred to in section 80CCD. It contributes 20% of basic salary to the account of each employee under the scheme. Dearness allowance paid is 40% of basic salary. 50% of dearness allowance forms part of pay for retirement benefits. Total basic salary of employees during the year ended 31st March, 2017 amounted to ₹ 100 lakhs. You are a finance executive of the company and get a basic salary of ₹ 20,000 per month and contribute 20% of basic salary to the pension scheme. On these facts:

(i) Compute the amount admissible as deduction under section 36(1)(iva) and the amount inadmissible under section 40A(9) in computation of business income of KLM Limited.

(ii) Explain the tax treatment in your hands.

Answer

(i) Computation of deduction allowable under section 36(1)(iva) and disallowance under section 40A(9) while computing business income of KLM Ltd.

Particulars	₹
Basic Salary	1,00,00,000
Dearness Allowance is 40% of basic salary, 50% of which forms part of pay for retirement benefits	20,00,000
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA which forms part of pay for retirement benefits)	1,20,00,000

Actual contribution (20% of basic salary i.e., 20% of ₹ 100 lakh)	20,00,000
Less: **Permissible deduction under section 36(1)(iva) (10% of salary computed as above = 10% of ₹ 1,20,00,000 = ₹ 12,00,000)**	12,00,000
Excess contribution disallowed under section 40A(9)	8,00,000

(ii) Tax treatment in the hands of the finance executive in respect of employer's and own contribution to pension scheme referred to in section 80CCD

(a) Employer's contribution to such pension scheme would be treated as salary since it is specifically included in the definition of "salary" under section 17. Therefore, ₹ 48,000, being 20% of basic salary of ₹ 2,40,000 will be included in salary.

(b) Own contribution to pension scheme is allowable as deduction under section 80CCD(1). However, the deduction is restricted to 10% of salary. Salary, for this purpose, means basic pay plus dearness allowance, if it forms part of pay for retirement benefits. Therefore, salary for the purpose of deduction under section 80CCD, in this case, would be –

Particulars	₹
Basic salary (₹ 20,000 × 12)	2,40,000
Dearness allowance = 40% of ₹ 2,40,000 = ₹ 96,000	
50% of DA forms part of pay = 50% of ₹ 96,000	48,000
Salary for the purpose of deduction under section 80CCD(1)	2,88,000
Deduction u/s 80CCD(1) = 10% of ₹ 2,88,000 (as against actual contribution of ₹ 48,000, being 20% of basic salary of ₹ 2,40,000)	28,800
₹ 28,800 is allowable as deduction under section 80CCD(1). This would be taken into consideration and be subjected to the overall limit of ₹ 1.50 lakh under section 80CCE.	

The balance ₹ 19,200 is allowable as deduction under section 80CCD(1B).

In the alternative, the entire contribution of ₹ 48,000 can be claimed as deduction under section 80CCD(1B), since the same is within the maximum cap of ₹ 50,000.

(c) Employer's contribution to pension scheme would be allowable as deduction under section 80CCD(2), subject to a maximum of 10% of salary. Therefore, deduction under section 80CCD(2), would also be restricted to ₹ 28,800, even though the entire employer's contribution of ₹ 48,000 is included in salary under section 17.

However, this deduction of employer's contribution of ₹ 28,800 to pension scheme would be outside the overall limit of ₹ 1.50 lakh under section 80CCE i.e., this deduction would be over and above the other deductions which are subject to the limit of ₹ 1.50 lakh.

Question 13

(a) 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 ₹ 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?

(b) 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?

Answer

(a) As per the provisions of section 36(1)(vii), bad debts written off as irrecoverable by the assessee shall be allowed as deduction while computing income under the head "Profit and gains from business or profession" in case such debt has been taken into account in computing the income of the assessee in the previous year or in any earlier previous year.

However, as per the Supreme Court's ruling in *CIT v. T. Veerabhadra Rao, K.Koteswara Rao & Co (1985) 155 ITR 152*, a successor to a business will be entitled to claim an allowance for bad debt under section 36(1)(vii) even though the debt was not incurred by it (i.e., the successor) but was incurred by the predecessor before takeover of the business by the successor.

Therefore, the claim for bad debts will be allowed even if the relevant debt had been taken into account in computing the income of the predecessor only and not in computing the income of the successor.

However, it is important that the identity of the business after succession remains the same.

Therefore in the present case, deduction under section 36(1)(vii) on account of bad debts of ₹ 5 lakh shall be allowed to Q. Limited in relation to a debt incurred by P. Limited for the engineering division transferred to Q. Limited, even though the same is not taken into account in computing the income of Q. Limited of the previous year or any earlier previous year, provided the identity of the business in the hands of Q Ltd remains the same.

(b) The issues under consideration are whether the expenses incurred on heart surgery can be regarded as:

(a) Current repairs to plant, allowable under section 31; or

(b) A revenue expenditure, incurred wholly and exclusively for the purposes of the assessee's profession and hence, allowable under section 37(1).

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 S is not tenable in law.

Question 14

A partnership firm consisting of three partners X, Y and Z is engaged in the business of manufacturing and selling toys.

Turnover of the business for the year ended 31st March, 2017 amounts to ₹ 175 lakh. Bad debts written off in the books are ₹ 75,000. Interest at 12% is provided to partner Z on his capital of ₹ 6 lakh as authorized by the partnership deed.

The firm had business loss of ₹ 50,000 and unabsorbed depreciation of ₹ 1,50,000 carried forward from Assessment Year 2016-17. The firm did not pay tax under presumptive tax system in assessment year 2016-17. The firm opts for presumptive taxation under section 44AD for Assessment Year 2017-18.

(i) Compute the income of the firm chargeable under the head "Profits and gains of business or profession."

(ii) *What would be the liability for interest under sections 234B and 234C, if the firm has not paid any advance tax?*

Answer

(i) Computation of income of the firm chargeable under the head "Profits and Gains of business or profession"

Particulars	₹
Presumptive income under section 44AD (8% of ₹ 175 lakh) **[See Note 1]**	14,00,000
Less: Brought forward business loss under section 72 **[See Note 4]**	50,000
Income of the firm chargeable under the head **"Profits and Gains of business or profession"**	**13,50,000**
Tax liability at @ 30.9%	4,17,150

Notes: -

(1) A partnership firm falls within the definition of "eligible assessee" under section 44AD. The threshold limit of turnover for applicability of presumptive taxation scheme under section 44AD is ₹ 200 lakh. In this case, since the turnover of the business of the firm is ₹ 175 lakh, it falls within the definition of "eligible business" and therefore, the firm is eligible to opt for presumptive taxation under section 44AD. 8% of the total turnover would be deemed to be the business income of the firm.

(2) As per section 44AD(2), all deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed.

Accordingly, no deduction shall be allowed for bad debts since the same is deductible under section 36(1)(vii) and similarly unabsorbed depreciation is not deductible since the same is deductible under section 32(2).

(3) Due to omission of proviso to section 44AD(2), interest on capital and working partner salary are also not deductible while computing the presumptive income of a partnership firm from the assessment year 2017-18 onwards.

(4) However, business loss of previous year 2015-16 can be set-off against current year business income as per section 72.

(ii) Since the partnership firm has opted for computation of income on presumptive basis under section 44AD, it must pay the whole amount of advance tax in one installment on or before 15.03.2017. Further, any amount paid by way of advance tax on or before 31st March shall also be treated as advance tax paid during each financial year on or before 15th March.

In case the firm has not paid advance tax or has paid advance tax less than the whole amount, then –

(a) it has to pay interest under section 234C at 1% on the short fall in payment of advance tax attributable to the month of March, 2017.

(b) it has to pay interest under section 234B @1% per month or part of a month on the short fall in payment of advance tax from 1st April, 2017 to the date of determination of total income under section 143(1) and where regular assessment is made, to the date of regular assessment.

Question 15

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.

Answer

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*.

Question 16

X Co. Ltd. was amalgamated with Y Co. Ltd. on 30.04.2016. X Co. Ltd. was engaged in real estate whereas Y Co. Ltd. was engaged in manufacture of textile goods. 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 ₹ 140 lacs by Y Co. Ltd. as against their original cost of ₹ 125 lacs to X Co. Ltd. for the purpose of amalgamation. Y Co. Ltd incurred ₹ 25 lacs towards development of those lands obtained on amalgamation. It sold the entire land for ₹ 160 lacs during the year ended 31.03.2017.

Determine the tax implication of the transaction in the hands of Y Co. Ltd. for the A.Y. 2017-18.

Answer

The provisions of section 43C would be attracted in this case. Where an asset, not being an asset referred to in section 45(2), which becomes the property of an amalgamated company under a scheme of amalgamation is sold by the amalgamated company as its stock in trade, then, the cost of acquisition of the said asset to the amalgamated company in computing the profits and gains derived from sale of such asset would be the cost of acquisition of such asset to the amalgamating company plus the cost of any improvement incurred thereto and the expenditure incurred wholly and exclusively in connection with such transfer by the amalgamating company.

In this case, since the stock-in-trade of X Co. Ltd. is taken over by Y Co. Ltd. on amalgamation, the provisions of section 43C are attracted and the cost of acquisition of vacant lands to Y Co. Ltd. (the amalgamated company) will be ₹ 125 lacs, being the original cost of such lands to X Co. Ltd., the amalgamating company.

The business income of Y Co. Ltd. on sale of such lands would be calculated as under -

Particulars	₹ (in lacs)	
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	
Cost of improvement (incurred by Y Co. Ltd)	25	150
Taxable business income chargeable in the hands of Y Co. Ltd		**10**

Note: *Since the stock in trade of X Co. Ltd. (being vacant land) is taken over by Y Co. Ltd., which altered its object clause on amalgamation to include real estate business, a view can be taken that the provisions of section 45(2) are not attracted in this case.*

Question 17

ILT Limited is engaged in manufacturing pipes and tubes. The profit and loss account of the company for the year ended 31st March, 2017 shows a net profit of ₹ 405 lacs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2017-18 indicating reasons for treatment of each item.

(i) A group free air ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2016-17. The same is encashed by the company for ₹ 10 lacs in April 2017 and credited to General Reserve Account.

(ii) A regular supplier of raw materials agreed for settlement of ₹ 8 lacs instead of ₹ 10 lacs for poor quality of material supplied during the previous year which was not given effect in the running account of the supplier.

(iii) Andhra Bank sanctioned and disbursed a term loan in the financial year 2013-14 for a sum of ₹ 50 lacs. Interest of ₹ 8 lacs was in arrear. The bank has converted the arrear interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.

(iv) *The company remitted ₹ 5 lacs as interest to a company incorporated in USA on a loan taken 2 years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15th July,2017. The said interest was debited to profit and loss account.*

(v) *Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31st May,2016 to 18th June, 2016 and 28th September, 2016 to 15th October, 2016 for the business development. The company has paid Sandeep's salary in cash, from its local office at Bangalore for the month of May, 2016 (payable on 1st June) and September 2016 (payable on 1st October), amounting to ₹ 45,000 and ₹ 47,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore. These were included in the amount of "salary" debited to Profit and Loss Account.*

(vi) *The company has contributed ₹50,000 by cheque to an electoral trust and the same stands included under the head "General Expenses".*

Answer

Computation of total income of ILT Ltd. for the A.Y.2017-18

Particulars	₹ (in lacs)	
Profits and gains from business or profession		
Net profit as per profit and loss account		405.00
Add : **Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed**		
Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.	10	
Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.	2	
Interest payable outside India to a foreign company is allowable **(See Note 1 below)**	-	
Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.	0.50	
Salary paid to employee Sandeep is eligible for deduction. Disallowance under section 40A(3) will not apply [See Note 2 below]	NIL	
		12.50
		417.50

***Less:* Amount of deduction allowable**		
Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee. Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e., converted loan) actually paid is allowable as deduction. Hence, ₹ 1,60,000, being two installments of ₹ 80,000 each, actually paid is deductible.		1.60
Business Income		**415.90**
Gross total income		**415.90**
Less: **Deduction under Chapter VI-A**		
Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.		0.50
Total Income		**415.40**

Notes:

1. Since tax has been deducted on interest payable outside India to a foreign company during the previous year 2016-17 and the same has been deposited before the due date of filing return of income under section 139(1), disallowance under section 40(a)(i) is not attracted. Since the interest has already been debited to profit and loss account, no further adjustment is required.

2. In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as the payments fall within the scope of Rule 6DD(i). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore which is not the place of his normal duty. Further tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. No disallowance under section 40A(3) is attracted in respect of such salary.

Question 18

ITP Limited is engaged in growing and manufacturing tea in India. It commenced its operations from 1st April, 2016. It acquired plant and machinery, factory building and furniture at a cost of ₹ 40 lacs, ₹ 25 lacs and ₹ 10 lacs, respectively in the P.Y. 2016-17. All the assets were put to use for more than 180 days during the P.Y. 2016-17 you are required to compute the written down value of each of the block of assets as on 1st April, 2017.

Answer

As per section 32, depreciation to be allowed has to be computed at the prescribed percentage on the written down value of any block of assets.

As per section 43(6), in the case of assets acquired before the previous year, the written down value means the actual cost to the assessee less all depreciation "actually allowed" to him under the Income-tax Act, 1961.

As per Rule 8 of the Income-tax Rules, 1962, only 40% of income from business of growing and manufacturing of tea in India is deemed to be income liable to tax. The balance 60% would be agricultural income, which is not chargeable to tax.

Explanation 7 to section 43(6) provides that in cases of composite income, for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable to tax under the head "Profits and gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

Therefore, even if only 40% of ITP Limited's income from sale of tea grown and manufactured in India is taxable, full depreciation (and not 40%) should be taken as "actually allowed" for the purpose of computing WDV. Accordingly, the WDV of each block as on 1st April 2017 will be as follows:

Plant & Machinery = ₹ 40 lacs – ₹ 6 lacs (15% of ₹ 40 lacs) = ₹ 34 lacs.

Building (Factory) = ₹ 25 lacs – ₹ 2.50 lacs (10% of ₹ 25 lacs) = ₹ 22.50 lacs.

Furniture = ₹ 10 lacs – ₹ 1 lacs (10% of ₹ 10 lacs) = ₹ 9 lacs.

Question 19

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.

Answer

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.

Question 20

G Ltd. is engaged in the business of growing and manufacturing tea in India. For the previous year ended 31.03.2016, its composite business profits before allowing deduction u/s 33AB is ₹ 60,00,000. On 01.09.2016, it deposited a sum of ₹ 11,00,000 in the Tea Development Account. During the previous year 2014-15, G Ltd. had incurred a business loss of ₹ 14,00,000 which has been carried forward. On 25.01.2017, it withdrew ₹ 10 lakhs, from deposit account which is utilized as under:

₹ 6,00,000 for purchase on non-depreciable asset as per the scheme specified.

₹ 3,00,000 for purchase of machinery to be installed in the office premises.

₹ 1,00,000 was spent for the purpose of scheme on 5.4.2017.

(i) You are required to determine business income of G Ltd. and the tax consequences that may arise from the above transactions in the relevant assessment year.

(ii) What will be the consequence if the asset which was purchased for ₹ 6,00,000 is sold for ₹ 8,00,000 in April, 2017.

Answer

(i) Computation of Business Income of G Ltd. for the A.Y. 2017-18

Particulars	₹
₹10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:	
- ₹ 6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme.	Not taxable

	[As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of ₹ 11 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y.2016-17 **(See Working Note below)**].	
-	₹ 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2016-17 as per section 33AB(4).	3,00,000
-	₹ 1,00,000 was spent for the purpose of scheme on 05.04.2017. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2016-17) in which the amount is withdrawn from the deposit account.	1,00,000

The entire amount of ₹ 10 lakh (forming part of ₹ 11 lakh deposited in Tea Development Account) was deducted in the assessment year 2016-17 before segregation of agricultural and non-agricultural income **(See Working Note below)**. Therefore, when any part of such amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated.

Accordingly, ₹ 1,60,000, being 40% of ₹ 4,00,000 (₹ 3,00,000 + ₹ 1,00,000) would be chargeable to tax as business income and the balance ₹ 2,40,000, being 60% of ₹ 4,00,000 would be agricultural income exempt from tax.

Working Note:

Computation of Business Income of G Ltd. for the A.Y. 2016-17

Particulars	₹
Composite business profits before allowing deduction under section 33AB	60,00,000
Less: Deduction under section 33AB(1) would be the lower of:	
- Amount deposited in Tea Development Account on or before 30.9.2016 [i.e., ₹ 11,00,000]	
- 40% of profits of such business [i.e., ₹ 24,00,000, being 40% of ₹ 60,00,000]	11,00,000
	49,00,000
Less: 60% of ₹ 49,00,000, being agricultural income [as per Rule 8]	29,40,000
Business income	19,60,000
Less: Brought forward business loss of A.Y.2015-16 set-off as per section 72	14,00,000
Business income chargeable to tax	5,60,000

(ii) Consequences, if asset purchased out of deposit account is sold during the previous year 2017-18

As per section 33AB(8), if the asset is sold before the expiry of eight years from the end of the previous year in which it was acquired, then, the cost of such asset shall be deemed to be the profits and gains from business or profession of the previous year in which asset is sold.

Therefore, ₹ 6,00,000 would be deemed to be the business income (composite) for the A.Y.2018-19. However, since the full cost of the asset was deducted in the assessment year 2016-17 (being part of ₹ 11 lakh deposited in Tea Development Account) before segregation of agricultural income and non-agricultural income, the agricultural and non-agricultural portions of income should be segregated in the year in which such amount becomes taxable on account of sale of asset before the expiry of eight years. Therefore, ₹ 3,60,000, being 60% of ₹6,00,000 would represent agricultural income. The balance ₹ 2,40,000 being 40% of ₹ 6,00,000 would be chargeable to tax as business income.

Moreover, the difference between the sale consideration and purchase price of the asset would be chargeable to tax as "Short term capital gains", which is computed as follows:

Sales consideration	8,00,000
Less: Cost of acquisition	6,00,000
Short term capital gain	**2,00,000**

Question 21

Explain in brief, the treatment as to their taxability and/or allowability, under the provisions of Income-tax Act, 1961, for the assessment year 2017-18, in the following cases:

(i) 'A' Ltd., an investment company, received dividend income of ₹ 1,00,000 on its investment in shares in domestic companies. It incurred interest expenditure of ₹ 2,00,000 on the borrowed capital utilized in the investment of shares.

(ii) 'B' Ltd. is a company engaged in the business of financing and investment in shares. It suffered loss of ₹ 3,00,000 on account of futures and options, a transaction in the form of derivatives in which the underlying asset was shares.

(iii) 'C' Ltd., which did not have any active business carried on by it incurred capital expenditure on scientific research amounting to ₹ 5,00,000 that related to its subsidiary company.

Answer

(i) The dividend income earned by 'A' Ltd. on the shares held as investment is exempt under the provisions of section 10(34). As per section 14A, no expenditure is allowable in respect of income which does not form part of total income. The interest paid on borrowed capital is an expenditure incurred in respect of shares purchased for investment. Since the dividend income received on shares is exempt and does not form part of total income of 'A' Ltd., the interest expenditure is not allowable as deduction in view of section 14A. [The quantum of disallowance must be in accordance with Rule 8D of the Income-tax Rules, 1962].

(ii) A transaction in derivatives, in which underlying asset is shares, is exempt from the purview of the speculative transaction, in terms of clause (d) of the proviso to section 43(5). As per the said clause, an eligible transaction in respect of trading in derivatives carried out in a recognized stock exchange shall not be deemed to be a speculative transaction. Accordingly, in the given case, if the transaction falls within the meaning of "eligible transaction" as defined in the *Explanation* therein, then the loss would be treated as an ordinary business loss eligible for set-off loss as per normal set-off provisions. On the other hand, if the transaction does not fall within the meaning of "eligible transaction", the loss would be treated as a speculation loss and can be set-off only against speculative income.

(iii) As per section 35(1)(iv), deduction in respect of capital expenditure on scientific research would be admissible under the provisions of section 35(2) only if the scientific research relates to the business carried on by the assessee.

However, in the given case, 'C' Ltd., did not have any active business carried on by it to which the said scientific research related to. The capital expenditure incurred by 'C' Ltd. related to its subsidiary company. Therefore, 'C' Ltd. is not eligible for deduction under the provisions of section 35(1)(iv) read with section 35(2).

Question 22

Indian Gas Limited commenced its operation of the business of laying and operating a cross country natural gas pipeline network for distribution on 1st July, 2016. The company incurred capital expenditure of ₹300 lacs (including cost of land ₹45 lacs and cost of financial instrument ₹5 lacs) during the period from 1st April, 2016 to 30th June, 2016. The company did not claim deduction for such expenditure in the earlier assessment years. The entire expenditure was capitalised on 1st July, 2016. Further, during the previous year 2016-17 (from July 2016), the company incurred capital expenditure of ₹200 lacs exclusively for the said business.

(i) *Compute the amount of deduction allowable under section 35AD assuming that the company has fulfilled all the conditions specified in section 35AD.*

(ii) *If the company has loss from such business in the assessment year 2017-18, how the same is to be set off and carried forward?*

Answer

(i) Section 35AD provides for investment-linked tax incentive for specified business. One such specified business is business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network. The benefit will be available in a case where the business relates to laying and operating a cross country natural gas pipeline network for distribution, if such business commences its operations on or after 1st April, 2007.

Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above business would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

Therefore, the deduction admissible under section 35AD for A.Y. 2017-18 would be:

Particulars	₹ (in lacs)
Capital expenditure incurred during the previous year 2016-17	200
Capital expenditure incurred during the period from 1st April 2016 to 30th June, 2016 (i.e. prior to commencement of business) and capitalized in the books of account on 1st July, 2016 (₹ 300 lacs - ₹ 50 lacs)	250
Total deduction under section 35AD for A.Y.2017-18	**450**

However, the actual deduction under section 35AD for A.Y. 2017-18 would be restricted to the profits derived from specified business for that year. The difference would be treated as loss from specified business to be carried forward as per section 73A.

(ii) Section 73A provides that any loss computed in respect of the specified business shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on. There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

However, loss determined as per section 73A can be carried forward and set-off only if it has been determined in pursuance of a return filed under section 139(3). Section 139(3) requires filing of return of loss mandatorily within the time allowed under section 139(1) for claiming carry forward of loss under, *inter alia,* section 73A.

Question 23

The trading and profit and loss account of Pingu Trading Pvt. Ltd. having business of agricultural produce, consumer items and other products for the year ended 31.03.2017 is as under:

Trading Account

Particulars	*₹*	*Particulars*	*₹*
Opening Stock	*3,75,000*	*Sales*	*1,55,50,000*
Purchases	*1,25,75,000*	*Closing Stock*	*4,50,000*
Freight & Cartage	*1,26,000*		
Gross profit	*29,24,000*		
	1,60,00,000		*1,60,00,000*

Profit and Loss Account

Particulars	*₹*	*Particulars*	*₹*
Bonus to staff	*47,500*	*Gross profit*	*29,24,000*
Rent of premises	*53,500*	*Income-tax refund*	*20,000*
Advertisement	*5,000*	*Warehousing charges*	*15,00,000*
Bad Debts	*75,000*		
Interest on loans	*1,67,500*		
Depreciation	*71,500*		
Sales-tax demand paid	*1,08,350*		
Miscellaneous expenses	*5,25,650*		
Net profit of the year	*33,90,000*		
	44,44,000		***44,44,000***

On scrutiny of records, the following further information and details were extracted / gathered:

(i) There was a survey under section 133A on the business premises on 31.3.2017 in which it was revealed that the value of closing stocks of 31.3.2016 was ₹ 8,75,000 and a sale of ₹ 75,000 made on 13.3.2017 was not recorded in the books. The value of closing stocks after considering these facts and on the basis of inventory prepared by the department as on 31.3.2017 worked out at ₹ 12,50,000, which was accepted to be correct and not disputed.

(ii) Income-tax refund includes amount of ₹ 4,570 of interest allowed thereon.

(iii) Bonus to staff includes an amount of ₹ 7,500 paid in the month of December 2016, which was provided in the books on 31.03.2016.

(iv) Rent of premises includes an amount of ₹ 5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.

(v) Advertisement expenses include an amount of ₹ 2,500 paid for advertisement published in the souvenir issued by a political party. The payment is made by way of an account payee cheque.

(vi) Miscellaneous expenses include:

(a) amount of ₹ 15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reasons beyond control,

(b) amount of ₹ 1,00,000 paid to the wife of a director, who is working as junior lawyer for taking an opinion on a disputed matter. The junior advocate of High Courts normally charge only ₹ 25,000 for the same opinion,

(c) amount of ₹ 1,00,000 paid to an Electoral Trust by cheque.

(vii) Sales-tax demand paid includes an amount of ₹ 5,300 charged as penalty for delayed filing of returns and ₹ 12,750 towards interest for delay in deposit of tax.

(viii) The company had made an investment of ₹ 25 lacs on the construction of a warehouse in rural area for the purpose of storage of agricultural produce. This was made available for use from 15.09.2016 and the income from this activity is credited in the Profit and Loss account under the head "Warehousing charges".

(ix) Depreciation under the Income-tax Act, 1961 works out at ₹ 65,000.

(x) Interest on loans includes an amount of ₹ 80,000 on which tax was not deducted.

Compute the income chargeable to tax for assessment year 2017-18 of Pingu Trading Pvt. Ltd, ignoring MAT. Support your answer with working notes.

Answer

Computation of Income of Pingu Trading Pvt. Ltd. chargeable to tax for the A.Y.2017-18

Particulars	₹
Net profit as per profit and loss account	33,90,000
Add: Difference in the value of stocks detected on survey under section 133A on 31.03.2017 chargeable as income **(See Note 1)**	3,75,000
	37,65,000
Less: Income-tax refund credited in the profit and loss account, out of which interest is to be considered separately under the head "Income from other sources"	20,000
	37,45,000
Add: **Expenses either not allowable or to be considered separately but charged in the profit & loss account**	
- Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not allowable as per section 30(a)(i). However, if such expenses are required for carrying on the business efficiently, the same are allowable under section 37. In this case, assuming that such expenses are required for carrying on business efficiently, the same are allowable under section 37.	
- Advertisement in the souvenir of political party not allowable as per section 37(2B) **(See Note 3)**	2,500
- Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed **(See Note 5)**	75,000
- Payment made to electoral trust by cheque **(See Note 6)**	1,00,000
- Penalty levied by the sales tax department for delayed filing of returns not allowable as being paid for infraction of law **(See Note 7)**	5,300
- Depreciation as per books	71,500

- 30% of interest paid on loan without deduction of tax at source not allowable as per section 40(a)(ia)		24,000
		40,23,300
Less: Depreciation allowable as per Income-tax Act, 1961		65,000
		39,58,300
Less: Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately **(See Note 8)**		15,00,000
Income from business (other than specified business)		**24,58,300**
Computation of income/loss from specified business (See Note 8)		
Income from specified business	₹ 15,00,000	
Less: Deduction under section 35AD @ 150% of ₹ 25 lakhs	₹ 37,50,000	
Loss from specified business to be carried forward as per section 73A	**(22,50,000)**	
Income from Other Sources		
Interest on income-tax refund		4,570
Gross Total Income		**24,62,870**
Less: **Deduction under section 80GGB**		
Contribution to political party **(See Note 3)**	₹ 2,500	
Contribution to an Electoral trust **(See Note 7)**	₹ 1,00,000	**1,02,500**
Total Income		**23,60,370**

Notes:

(1) The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-cast to arrive at the correct amount of the gross profit/ net profit for the purpose of return of income to be filed for the previous year ended on 31.3.2017.

REVISED TRADING ACCOUNT

Particular	₹	Particular	₹
Opening Stock	8,75,000	Sales (₹ 1,55,50,000 + ₹ 75,000)	1,56,25,000
Purchases	1,25,75,000	Closing Stock	12,50,000
Freight and Cartage	1,26,000		
Gross Profit	32,99,000		
	1,68,75,000		**1,68,75,000**

The difference of gross profit of ₹ 32,99,000 - ₹ 29,24,000 = ₹ 3,75,000 is to be added as income of the business for the year.

(2) Bonus for the previous year 2015-16 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2015-16. However, when the same has been paid in December 2016, it should be allowed as deduction in the P.Y.2016-17 (A.Y.2017-18). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.

(3) The amount of ₹ 2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expenditure falls within the meaning assigned to "contribute" under section 293A of the Companies Act, 1956, and is hence, eligible for deduction under section 80GGB. Any contribution to the political party or electoral trust made by way of cash is not allowed as deduction under section 80GGB. Since in the present case, the payment to the political party is made by way of an account payee cheque, it is allowed as deduction under section 80GGB.

(4) The penalty of ₹ 15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.

(5) It has been assumed that ₹ 25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only ₹ 25,000 for the same opinion and therefore, the balance ₹ 75,000 has been disallowed.

(6) Payment to an electoral trust qualifies for deduction under section 80GGB since the payment is made by way of a cheque. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.

(7) The interest of ₹ 12,750 paid on the delayed deposit of sales tax is for breach of contract and hence, is allowable as deduction. However, penalty of ₹ 5,300 for delay in filing of returns is not allowable since it is for breach of law.

(8) Weighted deduction @ 150% of the capital expenditure is available under section 35AD in respect of specified business of setting up and operating a warehouse facility for storage of agricultural produce which commences operation on or after 1.04.2012. It is presumed that ₹ 25 lacs does not include expenditure on acquisition of any land.

The loss from specified business under section 35AD (warehousing) should be segregated from the income from other businesses, since, as per section 73A(1), any loss computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

In view of the provisions of section 73A(1), the loss of ₹ 22.5 lacs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year. The return should be filed on or before the due date under section 139(1) for carry forward of such losses.

Question 24

During the year ended 31.3.2017, Geojit Marine Products Ltd. has made payment in cash to the tune of ₹ 60,000 on a single day to local fishermen, who regularly supply to them lobsters and *crabs. Will such cash payments be hit by the provisions of section 40A(3) of the Income-tax Act, 1961? Will your answer be different, if such cash payments are made to a hawker who supplies lobsters and crabs?*

Answer

Under section 40A(3), disallowance is attracted in the computation of income in a case where a payment or aggregate of payments exceeding ₹ 20,000 is made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft.

However, payment made otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeding ₹ 20,000 does not attract the aforesaid disallowance in certain circumstances as prescribed under Rule 6DD of the Income-tax Rules, 1962. Such exceptions, *inter-alia*, refer to payment made to the producer for the purchase of fish or fish products under sub-clause (iii) of clause (e) of Rule 6DD.

With regard to this sub-clause, the CBDT has, vide *Circular 10/2008 dated 5.12.2008*, issued the following clarifications –

(i) The expression 'fish or fish products' would include 'other marine products such as crab, lobster etc.'.

(ii) The 'producers' of fish or fish products would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

In view of the above circular, cash payment of ₹ 60,000 made to local fishermen for supply of lobsters and crabs, would not be hit by the provisions of section 40A(3).

However, the above exception will not be available in respect of payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

Therefore, the disallowance under section 40A(3) would be attracted if such cash payment of ₹ 60,000 on a single day is made to a hawker who supplies lobsters and crabs.

Question 25

Discuss the allowability of the expenses incurred on issue of partly-convertible debenture while computing income under the head "Profits and gains of business or profession".

Answer

The Madras High Court has, in *CIT v. South India Corporation (Agencies) Ltd. (2007) 290 ITR 217*, held that expenditure incurred on partly-convertible debentures is revenue expenditure eligible for deduction while computing business income. The High Court observed that the issue of shares is a future event, which may or may not happen. Since, at present, it is an expenditure incurred on the issue of debentures only, it is revenue expenditure eligible for deduction under section 37(1).

Question 26

XYZ Ltd. commenced operations of the business of laying and operating a cross-country natural gas pipeline network for distribution on 1st April, 2016. The company incurred capital expenditure of ₹ 32 lacs during the period January to March, 2016 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2016.

Further, during the financial year 2016-17, it incurred capital expenditure of ₹ 95 lacs (out of which ₹ 60 lacs was for acquisition of land) exclusively for the above business. Compute the deduction under section 35AD for the A.Y.2017-18, assuming that XYZ Ltd. has fulfilled all the conditions specified in section 35AD.

Answer

The amount of deduction allowable under section 35AD for A.Y.2017-18 would be –

Particulars	₹
Capital expenditure incurred during the P.Y.2016-17 (excluding the expenditure incurred on acquisition of land) = ₹ 95 lacs – ₹ 60 lacs	35 lacs
Capital expenditure incurred prior to 1.4.2016 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2016	32 lacs
Total deduction under section 35AD for A.Y.2017-18	**67 lacs**

Question 27

(a) A Ltd. paid IDBI (a public financial institution) a lump sum pre-payment premium of ₹ 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.

(b) Explain the tax treatment of emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.

Answer

(a) This issue came up before the Delhi High Court in *CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434*. The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section

36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that the pre-payment premium was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Note *– Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –*

(i) pre-payment premium represents interest as per section 2(28A);

(ii) such interest is deductible as business expenditure as per section 36(1)(iii);

(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

(b) As per ICDS V on Tangible Fixed Assets, machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised. Where the spares are capitalised as per the above requirement, the issue as to provision of depreciation arises – whether depreciation can be provided where such spares are kept ready for use or is it necessary that they are actually put to use. This issue was dealt with by the Delhi High Court in *CIT v. Insilco Ltd (2010) 320 ITR 322*. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note *– One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use for business purposes.*

Question 28

The business profit of T Ltd., a tea growing and manufacturing company, is ₹ 120 lacs (before deduction under section 33AB) for the assessment year 2017-18. It deposits ₹ 50 lacs with NABARD for claiming deduction under section 33AB. It wants to claim set-off of brought forward business loss of ₹ 40 lacs of the assessment year 2012-13. Find out the taxable income of T Ltd. for the assessment year 2017-18.

Answer

An assessee, engaged in growing and manufacturing tea in India, is entitled to a deduction under section 33AB, in respect of the amount deposited to an account maintained with NABARD as per scheme approved by Tea Board. The deduction is lower of the following two amounts –

(i) Amount deposited to the account maintained with NABARD within 6 months from the end of the previous year or before the "due date" for filing the return of income, whichever is earlier;

(ii) 40% of profits of such business computed under the head "Profits and Gains of Business or Profession" before making any deduction under this section.

The above deduction will be allowed before set off of brought forward business loss under section 72.

Computation of taxable income of T Ltd. for the A.Y.2017-18

Particulars	₹ (in lacs)	₹ (in lacs)
Profit before deduction under section 33AB		120.00
Less: Deduction under section 33AB for deposit to the account with NABARD being lower of the following amounts:		
Amount deposited with NABARD	50	
40% of business profit i.e., 40% of ₹ 120 lacs	48	48.00
		72.00
Less: 60% of ₹ 72 lacs, being agricultural income as per Rule 8		43.20
		28.80
Less: Set of brought forward loss under section 72 of A.Y.2012-13		28.80
Taxable business income		**Nil**
Total Income		**Nil**

Note - *The balance business loss of ₹ 11.20 lacs (i.e., ₹ 40 lacs – ₹ 28.80 lacs) can be carried forward to the next year for set off against business income..*

Question 29

Sea Port Shipping Line, a non-resident foreign company operating its ships on the Indian Ports during the previous year ended on 31.3.2017, had collected freight of ₹ 100 lacs, demurrages of ₹ 20 lacs and handling charges of ₹ 10 lacs inclusive of an amount of ₹ 40 lacs collected in

US dollars for the cargo booked for JNPT (Mumbai) from Antwerp. The expenses of operating its fleet during the year for the Indian Ports were ₹ 110 lacs. The company denies its liability to tax in India. Examine.

Answer

The provisions of section 44B would apply in this case. This section provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7½% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.

(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive tax scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of ₹ 9.75 lacs (7½% on the total receipts of ₹ 130 lacs).

Question 30

Work out the total income for A.Y. 2017-18 of a partnership firm engaged in retail trade from the following particulars:

(i) Net profit of ₹ 1,65,000 arrived at after debit of interest on capital of partners of ₹ 1,80,000 and salaries to working partners of ₹ 4,80,000.

(ii) Total capital of the partners on which interest paid is debited in the profit and loss account was ₹ 10,00,000.

Answer

Computation of total income of the partnership firm for A.Y.2017-18

Particulars	₹	₹
Net Profit as per profit and loss account		1,65,000
Add : Interest on Capital		1,80,000
Salaries to Partners		4,80,000
		8,25,000

Less: Interest on capital allowable @ 12% on ₹ 10 lacs		1,20,000
Book Profits		**7,05,000**
Less: Admissible amount of salary as a percentage of book profits or actual paid, whichever is less		
90% of ₹ 3,00,000	2,70,000	
60% of ₹ 4,05,000	2,43,000	
	5,13,000	
Since, the actual salary of ₹ 4,80,000 paid to the working partners is lesser than the admissible amount of ₹ 5,13,000, the entire amount of ₹ 4,80,000 is allowable as deduction.		4,80,000
Total Income		**2,25,000**

Note: *It is presumed that the salary and interest payments are authorized by the partnership deed and the firm has not opted for the presumptive income determination under section 44AD.*

Question 31

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2017 was a loss of ₹ 100 lacs after charge of head office expenses of ₹ 200 lacs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2017-18.

Answer

Section 44C allows head office expenses (a) an amount equal to 5% of the adjusted total income; or (b) the amount actually incurred as is attributable to the business of the assessee in India – whichever is less.

For the purpose of computing the adjusted total income, the head office expenses of ₹ 200 lacs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2017-18 will be as under:

Particulars	₹(in lacs)
Net loss for the year ended on 31.03.2017	(100)
Add: Amount of head office expenses to be considered separately as per section 44C	200
Adjusted total income	100
Less: Head Office expenses allowable under section 44C is the lower of (i) ₹ 5 lacs, being 5% of ₹ 100 lacs and (ii) ₹ 200 lacs.	5
Income to be declared in return	95

Question 32

Atul Housing Finance Co. Ltd., engaged in the business of providing long-term finance for construction or purchase of houses in India for residential purposes, provides you the following particulars from its accounts for the year ended on 31.3.2017 and seeks your opinion as to availability of deduction under section 36(1)(viii) and the amount thereof:

Profits from the business computed as per Part D of Chapter IV of the Income-tax Act, 1961, but before claiming deduction under section 36(1)(viii) is ₹ 560 lacs

- *Paid-up share Capital*	*₹ 500 lacs*
- *General Reserve*	*₹ 100 lacs*
- *Balance in reserve created under section 36(1)(viii) on 31.3.2016*	*₹ 1,100 lacs*

Answer

According to section 36(1)(viii), a special deduction is allowed to specified entities engaged in eligible business. A housing finance company is a specified entity which is eligible for deduction under section 36(1)(viii) in respect of profits derived from the eligible business of providing long-term finance for construction or purchase of houses in India for residential purposes. The quantum of deduction, however, should not exceed 20% of the profits derived from eligible business computed under the head "Profits and gains of business or profession" (before making deduction under section 36(1)(viii)) carried to a special reserve account.

However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

Atul Housing Finance Co. Ltd. is a specified entity engaged in carrying on the eligible business of providing long-term finance for the construction or purchase of houses in India for residential purposes and accordingly, it is entitled to claim the deduction under section 36(1)(viii).

The maximum deduction would be ₹ 112 lacs (20% of ₹ 560 lacs, being the profits for the year). However, in such a case, the aggregate amount carried to special reserve account i.e. ₹ 1,212 lacs (₹ 1,100 lacs + ₹ 112 lacs) would exceed twice the amount of paid-up share capital and general reserve i.e., ₹ 1,200 lacs (2 x ₹ 600 lacs). Therefore, deduction will not be allowed under section 36(1)(viii) in respect of the excess of ₹ 12 lacs (₹ 1,212 lacs – ₹ 1,200 lacs). Deduction under section 36(1)(viii) for the A.Y.2017-18 would be ₹ 100 lacs (₹ 1,200 lacs – ₹ 1,100 lacs).

Question 33

Explain the meaning of "eligible expense" for the purposes of claiming benefit of section 35D.

Answer

The following are the expenditures eligible for amortization as preliminary expenses under section 35D -

(a) Expenditures in connection with –
   (i) the preparation of feasibility report;
   (ii) the preparation of project report;
   (iii) conducting market survey or any other survey necessary for the business of the assessee;
   (iv) engineering services relating to the assessee's business.

(b) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.

(c) Where the assessee is a company, in addition to the above, expenditure incurred –
   (i) by way of legal charges for drafting the Memorandum and Articles of Association of the company;
   (ii) on printing the Memorandum and Articles of Association;
   (iii) by way of fees for registering the company under the Companies Act, 1956;
   (iv) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus; and

(d) such other items of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation.

In the case of expenditure specified in item (a) above, the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or any other survey or the engineering services referred to must be carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board.

Question 34

'X' Ltd., transferred its fertilizer business to a new company ' Y ' Ltd., by way of demerger with effect from appointed date of 1.4.2016. It has satisfied all the conditions of demerger. Following further information is given:

(a) WDV of the entire block of plant and machinery held by 'X' Ltd. as on 1.4.2016 is ₹ 100 crores;

(b) Out of the above, WDV of block of plant and machinery of fertilizer division is 70 crores;

(c) 'X' Ltd. has unabsorbed depreciation of ₹ 50 lacs as at 31.3.2016;

On the above facts:

(i) You are required to explain the provisions of the Income-tax Act as regards allowability of depreciation, after demerger, in the hands of 'X' Ltd. and 'Y' Ltd for the year ended 31.3.2017 duly calculating the depreciation.

(ii) State, how the unabsorbed depreciation has to be dealt with for the assessment year 2017-18.

Answer

(i) In the case of a demerger, satisfying the conditions as laid down in section 2(19AA), the depreciation claim is governed by the provisions as under -

(1) As per *Explanation 7A* below section 43(1), where in a scheme of demerger, if the demerged company transfers any capital asset to the resulting company, being an Indian company, the actual cost of the capital asset transferred shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.

(2) The resulting company will be entitled to depreciation on the written down value of the block of assets transferred to it, which will be the written down value of the transferred assets of the demerged company immediately before the demerger [*Explanation 2B* to section 43(6)].

(3) *Explanation 2A* to section 43(6) provides that the written down value of the block of assets in the hands of the demerged company shall be the written down value of the block of assets of the demerged company for the immediately preceding previous year as reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.

(4) As per the above provisions, the calculation of depreciation on plant and machinery in the hands of 'X' Ltd. and 'Y' Ltd. is as under:

Particulars	**₹ (in crores)**	
	'X' Ltd.	**'Y' Ltd.**
WDV of plant and machinery as at 1st April, 2016	30.00	70.00
Add: Acquisition during the year	Nil	Nil
Less: Sale during the year	Nil	Nil
WDV as at 31st March, 2017 (before charging depreciation)	30.00	70.00
Less: Depreciation @ 15%	4.50	10.50
WDV as at 1st April, 2017	**25.50**	**59.50**

Note – It is presumed that Y Ltd. is an Indian company.

(ii) Set-off of unabsorbed depreciation:

(i) As per section 72A(4), on demerger, the unabsorbed depreciation directly relatable to the undertakings transferred to the resulting company is allowed to be carried forward and set off in the hands of the resulting company.

(ii) Where such unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, it has to be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company.

(iii) The demerged company and the resulting company would be allowed to carry forward and set-off their respective portion of unabsorbed depreciation, as calculated above, for an unlimited period as per section 32(2).

Question 35

Specify all those public facilities which have been notified by CBDT as infrastructure facility for the purpose of section 36(1)(viii).

Answer

The *CBDT, vide Notification No. SO 1153(E) dated 20.07.2006*, has notified the following public facilities as infrastructure facility for the purpose of section 36(1)(viii):

(1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962

(2) Mass Rapid Transit system

(3) Light Rail Transit system

(4) Expressways

(5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers

(6) Bus and truck terminals

(7) Subways

(8) Road dividers

(9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system

(10) Multilevel Computerised Car Parking.

Question 36

M/s. Nagdiwala Enterprises, a partnership firm constituted by a doctor and a non-doctor engaged in running a multispeciality hospital, seeks your opinion in the context of provisions of the Act as to allowability/chargeability of the following transactions for preparing its return for A.Y. 2017-18:

(a) Depreciation on the instruments, imported from U.K. for ₹ 2 lacs cleared by customs on 22.3.2017 after payment of duty of ₹ 1 lac, installed and ready for use from 26.3.2017. Only one operation with the help of such instruments was performed till 31.3.2017.

(b) The book profits calculated as per section 40(b) are ₹ 3 lacs and payment of salary to working partners was ₹ 1 lac. Clause for payment of salary to working partners though appears in the deed, but the same is silent as to quantum and the manner of distribution.

(c) Salary of ₹ 1,00,000 p.m. paid to the wife of a partner for working as an anesthetist. The normal salary of an anesthetist in the town is ₹ 75,000 p.m. or less.

(d) Purchase of medicines in cash on 18.12.2016 for ₹ 35,000.

(e) Capital expenditure of ₹ 10,000 incurred for promoting family planning amongst its employees.

(f) Interest of ₹ 3,000 paid on an overdraft of ₹ 1 lac taken for making payment of installment of advance tax of ₹ 1.25 lacs.

Note: Computation of income not required.

Answer

The allowability/chargeability of each of the transactions entered into by M/s Nagdiwala Enterprises for the purpose of computation of income for Assessment Year 2017-18 shall be as under:-

(a) The surgical instruments used by a firm engaged in the business of running a hospital are covered under the category of Plant & Machinery, on which the rate of depreciation is 15%. The depreciation on the instruments imported from U.K. is allowable to the firm since the same were put to use during the previous year ended on 31.3.2017. However, as the instruments were used in the previous year for less than 180 days, the allowable depreciation will be one-half of the normal depreciation. The cost of instruments is ₹ 3 lacs and the amount of depreciation thereon works out to ₹ 22,500 [₹ 3,00,000 × 15% × 50%].

(b) As per section 40(b), payment of remuneration to a working partner is allowable as deduction only if it is authorised by and in accordance with the terms of the partnership deed. *CBDT Circular No.739 dated 25.3.1996* clarifies that no deduction in respect of remuneration paid to partners is allowable unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration. If the partnership deed contains a clause for payment of salary to working partners without specifying the manner of quantification or manner of distribution of such salary, the payment of salary to the working partners cannot be construed to be authorised by and in accordance with the partnership deed and hence the same shall not be allowable.

(c) Section 40A(2) provides that if any expenditure in respect of which payment has been made to any relative of a partner of the firm and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the services for which the payment is made, then disallowance under this section is attracted to the extent the same is excessive or unreasonable. In this case, salary of ₹ 1,00,000 p.m. is paid to the partner's wife, who is working as an anesthetist. The fair market value of a similar service is ₹ 75,000 p.m. Therefore, disallowance under section 40A(2) is attracted to the extent of ₹ 25,000 p.m., since to that extent, the same is excessive.

(d) Section 40A(3) provides for 100% disallowance of an expenditure, in respect of which payment is made in a sum exceeding ₹ 20,000 otherwise than by way of account payee cheque or account payee bank draft. Therefore, the entire amount of ₹ 35,000 incurred for purchase of medicines in cash is disallowed under section 40A(3).

(e) Section 36(1)(ix) provides for deduction of 1/5th of capital expenditure incurred by companies to promote family planning amongst its employees. However, since the assessee in this case is a partnership firm, such expenses are not allowable as deduction under section 36(1)(ix).

(f) 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.*

Question 37

Raja Ltd., made a provision on 31.3.2017 of ₹ 85,500 against a bill of supplier of raw material by charging the amount to profit and loss account and claimed deduction thereof while computing the income chargeable to tax for A.Y. 2017-18. The amount of ₹ 40,000 not paid to the party till 31.3.2017 was paid in cash on 11.6.2017. The Assessing Officer issued show cause notice to the company to rectify the computation of income for the A.Y. 2017-18 on account of payment made in cash on 11.6.2017. Can the Assessing Officer do so?

Answer

Section 40A(3A) provides that where an allowance has been made in the assessment for any year in respect of any liability for any expenditure incurred by the assessee and subsequently, during any previous year, the assessee makes any payment in respect of such liability in a sum exceeding ₹ 20,000 otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft or through electronic transfer, the payment so made shall be deemed to be profits and gains of business or profession of the subsequent year.

Section 40A(3A) is attracted in this case since the company has made a cash payment of ₹ 40,000 in respect of a liability incurred and allowed earlier. Accordingly, ₹ 40,000, will be added in the computation of income for the A.Y.2018-19 (considering that the payment was made on 11.6.2017).

The action of the Assessing Officer to issue show cause notice to rectify the computation of income of assessment year 2017-18 is not valid. The payment would go to increase the assessable income of the assessee of the previous year relevant to the assessment year in which such payment is made i.e. income of the assessment year 2018-19, in this case.

Question 38

"Easy Call Ltd.", to provide telecom services in Mumbai, obtained a licence on 1.4.2014 for a period of 10 years ending on 31.3.2024 against a fee of ₹ 27 lacs to be paid in 3 installments of ₹ 9 lacs each by April, 2014, April, 2015 and April, 2016, respectively. The company has commenced business on 1.5.2015.

Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and the amount, if any, deductible for A.Y. 2017-18.

Answer

The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal instalments during the number of years for which the license is in force.

If the is payment made before the commencement of business: The deduction shall be allowed beginning with the year of commencement of business.

In any other case: It will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2017-18 is worked out below:-

(1) Previous year of payment	*(2)* Unexpired period of license	*(3)* Instalment paid (₹)	*(4) = (3)/(2)* Deduction in respect of each instalment (₹)
2014-15	9 years	9,00,000	1,00,000*
2015-16	9 years	9,00,000	1,00,000
2016-17	8 years	9,00,000	1,12,500
		27,00,000	3,12,500

The deduction under section 35ABB from assessment year 2017-18 shall be Rs.3,12,500.

Question 39

GP Tyres & Tubes (P) Ltd, Mumbai was incorporated on 31.12.2015 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 30.8.2016. The company commenced its manufacturing operations on 1.9.2016. The total cost of the plant and machinery installed in the unit is ₹ 100 lakhs. The said plant and machinery included second hand plant and machinery bought for ₹ 20 lakhs and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of ₹ 10 lakhs.

Compute the amount of deduction allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2017-18. Furnish explanations in support of your computation.

Answer

Computation of depreciation allowable for the A.Y. 2017-18

Particulars	₹ (in lakhs)	
Total cost of plant and machinery	100.00	
Less: Used for Scientific Research **(Note 1)**	10.00	
	90.00	
Normal Depreciation @ 15% on ₹ 90 lakhs		13.50

Additional Depreciation:			
Cost of plant and machinery		100.00	
Less: Second hand plant and machinery **(Note 2)**	₹ 20.00		
Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia) **(Note 2)**	₹ 10.00	30.00	
		70.00	
Additional Depreciation@20%			14.00
Depreciation allowable for A.Y.2017-18			**27.50**

Notes:

(1) As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since the entire expenditure is deductible under section 35.

(2) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing or engaged in the business of generation or generation and distribution of power, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, *inter alia*, –

(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, 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 "Profit and gains of business or profession" of any one previous year.

In view of the above provisions, additional depreciation cannot be claimed in respect of -

(i) Second hand plant and machinery; and

(ii) New plant and machinery purchased for scientific research relating to assessee's business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia).

Question 40

Mr. Sunil carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Punjab State Financial Corporation and State Bank of India and has not paid interest as detailed hereunder:

S.No.	*Particulars*	*₹*
(i)	*Punjab State Financial Corporation* *(Previous years 2013-14, 2014-15 & 2015-16)*	*36,00,000*

(ii)	*State Bank of India (Previous years 2014-15 & 2015-16)*	*72,00,000*
		1,08,00,000

Both Punjab State Financial Corporation and State Bank of India, while restructuring the loan facilities of Sunil during the financial year 2016-17, converted the above interest arrear as loan repayable in 36 equal installments.

During the year ended 31.3.2017, Sunil paid six installments to Punjab State Financial Corporation and five installments to State Bank of India.

Sunil claimed the entire interest of ₹1,08,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities for the financial year 2016-17.

Discuss whether his claim is valid?.

Answer

Section 43B allows deduction only on "payment" basis in respect of certain expenditure specified therein, irrespective of the method of accounting followed by the assessee. Such expenditure would be allowed as deduction in the previous year in which the liability to pay such sum was incurred only if the payment is made on or before the due date for filing the return of income under section 139(1). If the payment is made after the stipulated due date, deduction can be claimed only in the year of actual payment. Such specified expenditure include, *inter alia*,

(1) interest on loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation; and

(2) interest on any loan or advances from a scheduled bank.

A clarification has been given by way of *Explanations 3C and 3D* below section 43B. These explanations clarify that if any sum payable by the assessee as interest on any such loan or borrowing or advance is converted into a loan or borrowing or advance, the interest so converted shall not be deemed as actual payment, and hence would not be allowed as deduction on conversion. The clarificatory explanations reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment. Therefore, ₹ 1,08,00,000, being the aggregate of interest on loan (from a State Financial Corporation and a scheduled bank) converted into loan will not be allowed as deduction. Consequently, the claim of Mr. Sunil is not valid.

The manner in which the converted interest will be allowed as deduction has been clarified in *Circular No.7/2006 dated 17th July, 2006*. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Hence, the repayment of ₹ 16,00,000 during the financial year 2016-17, as detailed hereunder, will be allowed as deduction while computing the business income of Mr. Sunil in the assessment year 2017-18.

Particulars	₹
Paid to Punjab State Financial Corporation (₹ 36,00,000 x 6/36)	6,00,000
Paid to State Bank of India (₹ 72,00,000 x 5/36)	10,00,000
	16,00,000

Question 41

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2017:

(i) ₹ 2 crores in India on account of carriage of passengers from Chennai.

(ii) ₹ 1 crore in India on account of carriage of goods from Chennai.

(iii) ₹ 3 crores in India on account of carriage of passengers from Singapore.

(iv) ₹ 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2017 was ₹ 6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2017-18.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?

Answer

Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the amounts specified in sub-section (2) shall be the profits and gains chargeable to tax under the head "Profits and gains of business or profession". Sub-section (2) specifies the following amounts -

(a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder -

Particulars	₹
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000

Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of ₹ 7,00,00,000 is ₹ 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2017-18.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

Question 42

XYZ Ltd. incurred expenditure amounting to ₹ 3,00,000 in connection with the issue of rights shares and ₹ 2,00,000 in connection with the issue of bonus shares for the year ended 31.3.2017. The company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the assessment year 2017-18.

Answer

The Supreme Court has, in *Brooke Bond India Ltd. v. CIT (1997) 225 ITR 798 (SC),* held that expenditure incurred by a company in connection with issue of shares with a view to increase its share capital is directly related to the expansion of its capital base and, therefore it constitutes a capital expenditure.

The issue of rights shares results in expansion of the capital base of XYZ Ltd. Hence, expenditure of ₹ 3,00,000 incurred by the company in connection with the issue of rights shares is a capital expenditure and is not allowable as a business expenditure.

On the other hand, the issue of bonus shares does not result in inflow of fresh funds or increase in the capital employed. It is mere capitalization of reserves. The total funds available with the company and its capital structure will remain the same on issue of bonus shares. The Supreme Court, in *CIT v. General Insurance Corporation (2006) 286 ITR 232*, considered the effect of issue of bonus shares and ruled that expenditure incurred in connection with the issue of bonus shares was allowable as revenue expenditure. Hence, the expenditure amounting to ₹ 2,00,000 incurred in connection with the issue of bonus shares is deductible from its business profits for the assessment year 2017-18.

Question 43

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.

Answer

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.

Question 44

A Hindu undivided family is carrying on the business of purchase and sale of food grains. The Karta of the family manages the business. Can the Hindu undivided family pay salary to the Karta and claim the payment made as a deduction from the profits of its business? If so, what are the conditions and limitations for such payment?

Answer

The Supreme Court has, in *Jugal Kishore Baldeo Sahai v. CIT (1967) 63 ITR 238,* held that if remuneration is paid to the Karta of a Hindu undivided family (HUF) under –

(i) a valid agreement which is bona fide and

(ii) is in the interest of, and expedient for, the business of the family and

(iii) the payment is genuine and not excessive,

such remuneration would be an expenditure laid out wholly and exclusively for the purpose of business of the family and would be allowable as a deduction while computing the income of the HUF. The test which should be applied for judging, what is a valid agreement is, whether the agreement for payment of salary to the Karta was by or on behalf of all the members of the family and whether it was in the interests of the business of the family so that it could be justified on the grounds of commercial expediency.

Thus, the HUF can pay salary to the Karta for services rendered by him to the business of the family under a valid agreement, which may be expressed or implied. Such payment will be eligible for deduction from the business profits of the HUF, if it is not excessive and is not unreasonable. If the salary payment made to the Karta is excessive or unreasonable, the excess amount would be disallowed under section 40A(2).

Question 45

A company engaged in textile manufacturing, debited to its Profit & Loss Account a sum of ₹ 6,00,000, being the interest on loan of ₹ 60,00,000 taken for financing its expansion scheme. The plant and machinery purchased for the project with the loan were not received during the year and those were still in transit at the end of the year. Discuss the admissibility or otherwise of the interest on borrowing.

Answer

Interest paid in respect of capital borrowed for the purposes of business or profession is admissible under section 36(1)(iii). However, any amount of interest paid in respect of capital borrowed for acquisition of an asset for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction, whether or not the acquisition of asset is for the purpose of extension of existing business.

ICDS IX on Borrowing Costs requires capitalisation of borrowing costs directly attributable to the acquisition, of a qualifying asset, which includes plant and machinery, upto the time when the asset is first put to use.

In this case, the asset (plant & machinery) was not put to use till the end of the previous year. Therefore, interest of ₹ 6,00,000 will not be allowed as a deduction but would be capitalised. Hence, the cost of the asset shall be increased by the amount of interest and depreciation shall be admissible on the enhanced cost of ₹ 66,00,000, once the asset is put to use.

Question 46

A company had an inventory of closing stock on 31.3.2017, the cost of manufacture of which was ₹ 100 lacs. The goods were liable for excise duty. Since the excise duty was eligible for deduction only on actual payment, the company valued the closing stock at cost viz. ₹ 100 lacs. Discuss the position from the taxation point of view.

Answer

Under section 145A, the valuation of inventory has to be carried out by including the amount of duty actually paid **or incurred** by the assessee to bring the goods to the place of its location and condition on the date of valuation. Therefore, excise duty should be included in the valuation of closing stock as on 31.3.2017 and the deduction of such excise duty shall be subject to actual payment as mandated by the provisions of section 43B.

Question 47

The WDV of Plant and Machinery on 01-04-2016 of X Ltd. engaged in manufacturing of PVC granules is ₹ 1,000 lacs. Company purchased additional plant and machinery for ₹ 800 lacs on 18.04.2016 inclusive of a second-hand machine imported from China of ₹ 200 lacs. The production from new machine was taken w.e.f. 1.12.2016.

Workout the amount of allowable depreciation and support your answer with reasons.

What would be your answer in case X Ltd is an undertaking newly set up in Vaishali, a notified backward area in the State of Bihar on 1.4.2016 and it has purchased new plant machinery for ₹ 800 lacs, as given above?

Answer

As per section 32(1)(iia), an assessee engaged in the business of manufacture or production of any article or thing or engaged in the business of generation of generation and distribution of power is entitled for an additional depreciation @ 20% of the actual cost of such plant & machinery acquired and installed.

Additional depreciation shall, however, not be available in respect of those plant & machinery which, before its installation by the assessee, were used either within India or outside India by any other person.

The depreciation allowable will be as under:-

Particulars	₹ (in lacs)
Depreciation on WDV of machinery as on 1st April, 2016 - ₹ 1000 lacs @ 15%	150
Depreciation on plant & machinery purchased on 18th April but actual production commenced w.e.f. 1st December. Depreciation will be restricted to 50% of the normal depreciation i.e. 50% of (₹ 800 lacs x 15%)	60
Additional depreciation @ 20% of the actual cost of new plant & machinery. This depreciation is also to be restricted to 50% since production has commenced only on 1st December.	
50% of (20% of ₹ 600 lacs)	60
Total Depreciation	**270**

Note – *When an assessee sets up an industrial undertaking in Vaishali, a notified backward area in the State of Bihar on or after 01.04.2015, it is eligible for accelerated depreciation at 35% instead of 20%. The regular rate of depreciation, however, would remain the same at 15%.*

Particulars	₹ (in lacs)
Depreciation on plant & machinery purchased on 18th April but actual production commenced w.e.f. 1st December. Depreciation will be restricted to 50% of the normal depreciation i.e. 50% of (₹ 800 lacs x 15%)	60
Additional depreciation @ 35% of the actual cost of new plant & machinery. This depreciation is also to be restricted to 50% since production has commenced only on 1st December. 50% of (35% of ₹ 600 lacs*)	105
Total Depreciation	**165**

*Total acquisition minus imported second hand machinery.

Question 48

Alpha Ltd., a manufacturing company, has disclosed a net profit of ₹ 12.50 lacs for the year ended 31st March, 2017. You are required to compute the taxable income of the company for the Assessment year 2017-18, after considering the following information, duly explaining the reasons for each item of adjustment:

(i) Advertisement expenditure debited to profit and loss account includes the sum of ₹ 60,000 paid in cash to the sister concern of a director, the market value of which is ₹ 52,000.

(ii) Repairs of plant and machinery debited to profit and loss account includes ₹ 1.80 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.

(iii) A sum of ₹ 6,000 on account of liability foregone by a creditor has been taken to general reserve. The same was debited to the Revenue Account in the A.Y. 2014-15.

(iv) Sale proceeds of import entitlements amounting to ₹ 1 lac has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.

(v) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:

(a) Research equipments purchased ₹ 1,50,000.

(b) Remuneration paid to scientists ₹ 50,000.

The total amount of ₹ 2,00,000 is debited to the profit and loss account.

Answer

Computation of taxable income of Alpha Ltd. for the A.Y.2017-18

Particulars	₹
Net profit as per profit and loss account	12,50,000
Add: Items debited to profit and loss A/c but not deductible	
1. Payment of advertisement expenditure of ₹ 60,000	
(i) ₹ 8,000, being the excess payment to a relative disallowed under section 40A(2)	8,000
(ii) As the payment is made in cash and since the remaining amount of ₹ 52,000 exceeds ₹ 20,000, 100% shall be disallowed under section 40A(3)	52,000
2. Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction. The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or	

	substantial part of the entire machinery [*CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)]*. Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment is required. Further, as per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost.	
3.	Liability foregone by creditor chargeable as business income but not credited to profit and loss account [taxable under section 41(1)]	6,000
4.	Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiia). As the amount has already been credited to profit and loss account, no further adjustment is necessary.	-
Less:	Amount not debited to profit and loss account but allowable as deduction	
5.	Expenditure on in-house research and development is entitled to a weighted deduction of 200% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = ₹ 2 lacs x 200% = ₹ 4 lacs Expenditure of ₹ 2,00,000 has already been debited to Profit & Loss Account, therefore only additional deduction of ₹ 2 lacs further to be allowed Note: It would be eligible for 150% instead of 200% from the assessment year 2018-19 onwards and would be eligible for 100% deduction from the assessment year 2021-22 onwards.	2,00,000
	Taxable Income	**11,16,000**

Question 49

By virtue of an agreement entered into on 1.9.2016 between X Ltd. and Y Ltd., X Ltd. agrees not to carry on any business relating to computer software in India for the next 12 years. In return Y Ltd. agreed to pay a sum of ₹ 12,00,000 to X Ltd. The said amount was paid on 1st December, 2016. Indicate the treatment of such receipt in the hands of X Ltd. Also discuss the TDS implications, if any, in the hands of Y Ltd.

Answer

As per section 28(va), any sum received or receivable, in cash or kind, for not carrying out any activity in relation to any business shall be taxable as profits and gains of business or profession.

The instant case clearly falls within the ambit of section 28(va). As such, the receipt of ₹ 12,00,000 is chargeable to tax as business income in the hands of X Ltd.

Question 50

(i) A corporation was set up by the State Government transferring all the buses owned by it for a consideration of ₹ 75 lacs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the depreciation be denied in the Corporation's hands on the ground that there was no registration of the buses in favour of the Corporation?

(ii) Ravi succeeded to his father's business in the year 2015. In the previous year ended 31.3.2017, Ravi has written off the balance in the name of 'Y' which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.

Answer

(i) The decision of the Supreme Court in *Mysore Minerals Ltd v. CIT (1999) 239 ITR 775* is relevant in the context of the facts stated. The term "asset used" in section 32 must be assigned a wider meaning and anyone in possession of property in his own title, exercising dominion over the property, to the exclusion of others and having the right to use and enjoy it, must be taken to be the owner.

Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot, therefore, be denied depreciation on the buses. A similar decision was also taken in *CIT v. J & K Tourism Development Corporation (2001) 114 Taxman 734 (J&K).*

(ii) The deduction of bad debt is allowed if it is written off in the books of account of the assessee. In this case, Ravi has succeeded to the business carried on by his father. Under clause (vii) of section 36(1) the amount has been written off in the books of account as irrecoverable is eligible for deduction provided the debt has been taken into account in computing the income of the business in an earlier previous year [vide section 36(2)].

Therefore, Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount due for the supplies made by previous owner viz. deceased father of Ravi. [*CIT v. T.Veerabhadra Rao, K.Koteswara Rao and Co (1985) 155 ITR 152 (SC)]*.

Question 51

Boat Club is an association governed by the provisions of Section 44A of the Income-tax Act, 1961. The subscription received from members for the year ended 31st March, 2017 was ₹ 2,00,000. The expenditures in the normal course of its activities were ₹ 3,85,000. Its other income taxable under the Act works out to ₹ 2,75,000. You are consulted as to how Boat Club's income would be determined for assessment year 2017-18?.

Answer

As per section 44A, the deficiency arising on account of income from members by way of, *inter alia*, subscriptions, falling short of the expenditure incurred solely for the protection or advancement of the interest of its members, shall first be set off against the association's income under the head “Profits and gains of Business or Profession”. If there is no such income under this head, the deficiency shall be set off against income under any other head.

Particulars	₹
Income from subscription	2,00,000
Less: Expenses incurred in the course of its activities	3,85,000
Deficiency	(-)1,85,000
Other income	2,75,000
Less: Deficiency Rs.1,85,000 but limited to 50% of other income	1,37,500
Income of the Association	1,37,500

There is a ceiling on the deduction admissible by way of deficiency being that it shall not exceed one-half of the total income of the association computed before making any allowance under this section. This ceiling has been exceeded above and the deficiency hence is limited to ₹ 1,37,500 being one-half of ₹ 2,75,000 [vide section 44A(3)].

Question 52

Praveen was a partner in a firm in his capacity as the Karta of HUF. On the amounts deposited by the partners, the firm paid interest. Praveen, in his individual capacity also made deposit in the same firm in which he was a partner. The assessee claimed that the interest paid in his individual capacity is not liable for disallowance under section 40(b). The Assessing Officer did not agree and hence disallowed the interest paid to Praveen in his individual capacity. Discuss.

Answer

Explanation 1 to section 40(b) clearly states that where an individual is a partner in a firm, in a representative capacity, interest paid by the firm to such individual in his individual capacity shall not attract disallowance under section 40(b).

Since Praveen is a partner in his capacity as the Karta of his HUF and the interest is paid by the firm in his individual capacity, such interest is not hit by the provisions of section 40(b).

This position was brought out by the Supreme Court in *Brij Mohan Das Laxman Das v. CIT (1997) 223 ITR 825* and followed by the Madras High Court in the case *R.M. Appavu Chettiar Sons v. CIT (2002) 256 ITR 289 (Mad)*. Therefore, the Assessing Officer’s action in disallowing the interest paid to Praveen in his individual capacity is not correct.

Question 53

What is the meaning of “successor in business” for the purpose of section 41(1) of the Income-tax Act, 1961?

Answer

For purposes of section 41(1) of the Income-tax Act, 1961, “successor in business” means –

(i) In the case of amalgamation of companies, the amalgamated company.

(ii) In the case a person is succeeded by another person in that business or profession of the first mentioned person, the other person.

(iii) Where a firm carrying on a business is succeeded by another firm, the other firm.

(iv) Where there has been a demerger, the resulting company.

Question 54

Capsule Ltd, during the financial year ended 31.3.2017 paid production bonus of an amount of ₹ 30 lacs pursuant to a settlement arrived with the workers in addition to the statutory payment of ₹ 10 lacs as per the Payment of Bonus Act, 1965. Your advise is sought on the following:

(a) Whether the sum of ₹ 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?

Answer

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.

₹ 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 ₹ 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.

Question 55

You are consulted on the justifiability of the following claims. Your advice is to be framed based on the provisions of the Income-tax Act, 1961.

(i) A company paid the full consideration towards cost of administrative office building and occupied the same before 31st March. The registration did not take place before the end of the previous year. Can the depreciation claim be made?

(ii) Secret commission was paid and debited under Commission Account. Is it an allowable deduction?

Answer

(i) One of the conditions for the claim of depreciation under the provisions of section 32 of the Income-tax Act, 1961 is that the assessee should be the owner of the asset. In the facts of the given case, the asset is an immovable property, namely, buildings acquired for the administrative office. Full consideration has been paid. However, the registration could not take place before the end of the previous year.

The Supreme Court had an occasion to consider this issue in the case of *Mysore Minerals Ltd v. CIT 239 ITR 775.* The Supreme Court stated that the very concept of depreciation suggests that tax benefit on account of depreciation legitimately belongs to one who has invested in the capital asset and is utilizing the capital asset.

In the facts of the given case, though the document of title was not executed, the full consideration has been paid and the dominion over the property by taking possession excluded the owner who had to transfer the asset and therefore the right to use and occupy the property and enjoy it was exercised by taking possession and the execution of the formal deed of title may take place at any given point of time.

Following the decision of the Supreme Court, depreciation can be claimed in respect of the building that is acquired for the administrative office, though registration has not yet taken place.

However, the depreciation would be restricted to 50%, if the asset is put to use for less than 180 days in the year.

(ii) Secret commission is one of the forms of commission payment generally made by business organizations. Secret commission is a payment for obtaining business orders or contracts from parties and /or customers and paid to employees and / or officials of those parties and / or customers or companies from whom business orders are obtained by the assessee.

The *Explanation* below section 37(1) of Income-tax Act, 1961 provides that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. In view of the Explanation, any expenditure incurred for a purpose which is an offence and prohibited by law cannot be allowed as expenditure. Therefore, if secret commission payment could be established as a payment for an offence prohibited by law, the same cannot be allowed as deduction.

Question 56

M/s. PR and M/s. ST are firms with same set of partners but carrying on different businesses. M/s. PR took loan from M/s. ST for the purpose of its business. Interest on the loan for the year ended 31.3.2017 was ₹ 2,00,000. M/s. PR deducted tax of ₹ 20,000 on interest and paid the balance to M/s. ST on 31.3.2017. Tax deducted was remitted to the credit of the Central Government on 1.12.2017. How will you treat the interest paid while computing the total income of M/s. PR for the assessment year 2017-18?

Answer

Section 40(a)(ia) provides that 30% of any sum payable to resident shall not be allowed as deduction in computing business income, if tax deductible at source has not been deducted thereon or if deducted, has not been remitted on or before the prescribed time. The time limit for remitting the amount of tax deducted at source is upto the 'due date' for filing the return prescribed under section 139(1) i.e. 30th September, 2017. Thus, the remittance on 1.12.2017 i.e., after the due date of filing of return, would attract disallowance of ₹ 60,000 (30% of ₹ 2,00,000) under section 40(a)(ia). The fact that M/s PR & M/s ST are firms with common partners is not relevant in this context.

Question 57

An Indian company is engaged in the manufacture and sale of coffee grown by it in its own estates. Will it be liable to tax under the Income-tax Act, 1961 and if so, how will its income be determined?

Answer

As per Rule 7B, income derived from the sale of coffee grown and cured by the seller in India, shall be computed as if it were income derived from business and 25% of such income shall be deemed to be income liable to tax.

Income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India with or without mixing chicory or other flavouring ingredients, shall be computed as if it were income from business and 40% of such income shall be deemed to be income chargeable to tax.

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

Question 58

An Australian aviation company flying an aircraft in India which has paid tax on presumption basis and under section 44BBA claims that the non-resident employees deputed for flying this aircraft shall not be subjected to tax on the remuneration to the extent paid out of such income, on the basis of Article 15 of the DTAA between India and Australia, as per which one of the conditions for exemption of remuneration of employees is that the same is not deductible while determining the profits chargeable to tax of the employer. Is the claim justified?

Answer

Section 44BBA provides for deeming 5% of aggregate of amounts received by/paid or payable to a non-resident assessee engaged in the business of operation of aircrafts, for carriage of passengers, livestock, mail or goods, as profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

As per Article 15 of the DTAA between India and Australia, one of the conditions for exemption of remuneration of employees resident of Australia is that such remuneration should not be deductible in determining the profits chargeable to tax of the non-resident aviation company.

The issue under consideration is whether employees deputed for flying the aircraft in India would be exempt from tax on the remuneration received from the non-resident aviation company to the extent paid out of income which is subject to tax in India on the basis of presumptive taxation provisions under section 44BBA.

This issue came up before the Authority for Advance Rulings in the case of *Lloyd Helicopters International Pty Ltd. (2001) 249 ITR 162*, wherein it was observed that the profits determined under section 44BBA, though arrived at on a statutory basis, cannot be considered to exclude such expenses as non-deductible merely because the statute fixes a percentage in this regard. The fixation of a rate as low as 5% of gross receipts indicates the statutory attempt at estimating and allowing expenses normally likely to be incurred in such business, which includes remuneration of employees.

Therefore, applying the rationale of the AAR ruling, the remuneration paid to employees is deemed to have been deducted while computing the profits chargeable to tax of the employer i.e., the non-resident aviation company under section 44BBA. Accordingly, the said remuneration paid to non-resident employees shall not be exempt from tax in India.

The claim of the non-resident aviation company is, therefore, not justified.

Exercise

1. *Is it compulsory for an assessee to claim depreciation under section 32 of the Income-tax Act, 1961?*

2. *The written down value of plant and machinery in the books of Alpha Ltd. is ₹ 75,00,000 as on 1st April, 2016, on which date, the installed capacity of the company was 12,000 tons. Alpha Ltd. borrowed ₹ 10,00,000 @ 10% p.a. from ICICI Bank on 1.8.2016 for purchase of new plant and machinery costing ₹ 15 lacs for extension of its existing business, which would increase its installed capacity to 13,000 tons. The new plant and machinery was purchased on the same date but was put to use only w.e.f. 1.11.2016. Compute the depreciation admissible under section 32 for the A.Y.2017-18, assuming the applicable rate of depreciation on plant and machinery to be 15%.*

3. *PQR Ltd., a non-banking finance company was engaged in the business of leasing and hire purchase. It purchased motor cars from Ramaha motors and leased out these vehicles to its customers. The lease agreement with the customer stated that PQR Ltd. was empowered to repossess the vehicle, in case the lessee committed a default. Registration of the vehicle in the name of lessee, during the period of lease is mandatory as per the Motor Vehicles Act, 1988. PQR Ltd. claimed ₹ 5,00,000 as depreciation on the vehicles leased out for the year ended 31.03.2017. The claim was rejected by the Assessing Officer on the ground that the assessee had merely financed the purchase of motor cars and was neither the owner nor the user of these assets. Is the action of the Assessing Officer valid? Discuss.*

Answers

3. The issue under consideration in this case is whether depreciation on leased vehicles can be denied to the lessor (PQR Ltd.) on the grounds that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of vehicles.

This issue came up before the Supreme Court in *I.C.D.S Ltd. v. CIT (2013) 350 ITR 527.* The Court observed that section 32 imposes a twin requirement of "ownership" and "usage for business" as conditions for claim of depreciation thereunder. As far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself.

In this case, PQR Ltd. did use the vehicles in the course of its leasing business. Hence, the requirement of section 32 has been fulfilled, notwithstanding the fact that PQR Ltd. was not the actual user of the vehicles.

In *I.C.D.S. Ltd.'s* case, the Supreme Court further observed that the Motor Vehicle Act, 1988 contains a deeming provision which creates a legal fiction of ownership in favour of the lessee only for that Act and not for the purpose of law in general. No inference could be drawn from the registration certificate as to ownership of the vehicles, since registration in the name of the lessee during the period of lease is mandatory as per the Motor Vehicles Act, 1988.

Therefore, as long as the lessor has a right to retain the legal title against the rest of the world, it would be the owner of the asset in the eyes of law. In this case, PQR Ltd., the lessor, is the exclusive owner of the vehicle at all points of time as he is empowered to repossess the vehicle, in case the lessee committed a default. The proof of ownership lies in the lease agreement itself, which clearly points in favour of PQR Ltd.

Applying the rationale of the Supreme Court ruling in *I.C.D.S Ltd.'s case*, the action of the Assessing Officer in this case denying the depreciation claim of PQR Ltd. is not valid.

7

Capital Gains

Question 1

Often controversies arise between the assessee and the department on the issue of treatment of gain arising out of transactions of sale and purchase of shares and securities.

Based on the judicial decisions, narrate the significant points of distinction in order to judge the purpose and motive of the assessee for its different treatment as income from business or income from capital gain.

Answer

The profit arising to an assessee from the transaction of sale and purchase of shares and securities, can be treated either as business income or capital gains.

The profit would be treated as business income if shares and securities constitute a trading asset and the assessee is a trader of shares and securities. However, the profit would be taxable under the head "Capital Gains", if the shares and securities are held as an investment i.e., a capital asset.

The original purpose or intention is crucial. If the original intention was to hold the shares as investment, the gains resulting from the sale of such shares will be capital gains. On the other hand, if the original intention was to carry on the activities of purchase and sale as a systematic activity and hold the shares as stock-in-trade, the gains resulting from the sale of such shares will be assessable as business income.

It is open to the assessee to maintain two portfolios, one for investments and another for dealing in shares. It was so observed by the Bombay High Court, in *Gopal Purohit vs. CIT (2011) 336 ITR 287,* where it was held that there should be uniformity in treatment and consistency in treating transactions in shares as investment or stock-in-trade, when facts and circumstances were identical. Further, the High Court also held that entries in the books of account alone are not conclusive in determining the nature of income.

In case the purchase and sale of the shares and securities is undertaken with a motive of earning profit out of the transaction, then the same would result in a trading transaction and will give rise to business income whereas if the motive of investment in the shares and securities is to earn income by way of dividend or interest, as the case may be, then the profit arising from the transaction of sale and purchase of such shares and securities will give rise to capital gain and not business income.

The magnitude of purchase and sale, the ratio between the purchase and sale of the shares and securities and holding period of the same can be considered for determining the purpose and the motive of the assessee for undertaking such transaction.

Notes

(i) Securities held by a Foreign Institutional Investor (FII), which has invested in such securities in accordance with SEBI regulations, would fall within the definition of capital asset, even if the nature of such security in the hands of the Foreign Portfolio Investor is stock-in trade. Consequently, the profit on transfer of such securities would be taxable as capital gains.

*(ii) **CBDT Circular No. 6/2006/2016 dated 29.2.2016** - The CBDT has, vide this circular, clarified the following:*

*(a) **Where assessee opts to treat listed 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.

Question 2

What are the consequences if the amount deposited in Capital Gains Account Scheme to avail exemption from capital gains is not utilised within the stipulated time? Is there any difference in the tax treatment in the event of death of the assessee before the stipulated time?

Answer

Where the amount deposited in Capital Gains Accounts Scheme is not utilized for the specified purpose mentioned under the respective section providing for exemption (like say, section 54, 54B, 54G, etc.) within the specified period of two years or three years, as the case may be, mentioned therein, then the **unutilized amount shall be charged under section 45 as capital gain** of the previous year in which the specified period of two years or three years, as the case may be, expires.

The tax treatment will be different where before the stipulated time, the assessee expires and the amount is received by his legal heirs.

The CBDT has, in *Circular No.743 dated 6.5.1996*, clarified that in the event of death of an individual before the stipulated period, the unutilized amount would not be chargeable to tax in the hands of the legal heirs of the deceased individual, since such unutilized amount is not income but is a part of the estate devolving upon them.

Question 3

"Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of share or shares held in a company by a shareholder on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45 subject to fulfillment of certain conditions". Explain in the context of the provisions contained in the Act.

Answer

Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of a share or shares held in a company by a shareholder on conversion of a company into a LLP shall not be regarded as a transfer for a purpose of levy of capital gains tax under section 45 on fulfillment of the following conditions:-

(1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lacs in any of the three preceding previous years;

(2) the total value of assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which conversion taken place does not exceed ₹ 5 crores;

(3) all the shareholders of the company immediately before the conversion become partners of the LLP and their capital contribution and profit sharing ratio in the LLP are also in the same proportion as their shareholding in the company on the date of conversion;

(4) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders of the company;

(5) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of at least 5 years from the date of conversion;

(6) all assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP; and

(7) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company standing in the accounts on the date of conversion, for a period of 3 years from the date of conversion.

Question 4

Hari has acquired a residential house property in Delhi on 1st April, 2001 for ₹ 10,00,000 and decided to sell the same on 3rd May, 2004 to Ms. Pari and an advance of ₹ 25,000 was taken from her. The balance money was not paid by Ms. Pari and Hari has forfeited the entire advance sum. On 3rd June, 2016, he has sold this house to Mr. Suri for ₹ 35,00,000. In the meantime, on 4th April, 2016, he had purchased a residential house in Delhi for ₹ 8,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, Hari does not possess any legal title till 31st March, 2017, as such transfer was not registered with the registration authority.

Hari has purchased another old house in Chennai on 14th October, 2016 from Mr. X, an Indian resident, by paying ₹ 5,00,000 and the purchase was registered with the appropriate authority.

Determine the taxable capital gain arising from above transactions in the hands of Hari for Assessment Year 2017-18 [Cost inflation Index - 2001-02: 426; 2004-05: 480; 2016-17: 1125]

Answer

Computation of taxable capital gain of Mr. Hari for the A.Y.2017-18

Particulars	₹
Sale proceeds	35,00,000
Less: Indexed cost of acquisition **(See Note 1)**	25,74,824
Long Term Capital Gain	9,25,126
Less: Exemption under section 54 in respect of investment in house at Delhi **(See Note 2)**	8,00,000
Taxable long-term capital gain	**1,25,176**

Notes:

1. **Computation of indexed cost of acquisition**

Particulars	₹
Cost of acquisition	10,00,000
Less: Advance taken and forfeited	25,000
Cost for the purpose of Indexation	9,75,000
Indexed cost of acquisition (₹ 9,75,000 x 1125/426)	25,74,824

Note: *Advance received and forfeited on or after 01.04.2014 is taxable under section 56(2)(ix). Such amount would not be reduced to compute indexed cost of acquisition while determining capital gains on sale of such property.*

However, in this case, since the advance was received and forfeited in the year 2004, such advance has to be reduced for calculating indexed cost of acquisition for the purpose of arriving at capital gains.

2. In order to avail exemption of capital gains under section 54, a new residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Hari has purchased the residential house in Delhi within one year before the date of transfer and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2017 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in *Balraj v. CIT(2002) 254 ITR 22 (Del.) and CIT v. Shahzada Begum (1988) 173 ITR 397 (A.P.).*

3 Section 54 provides that exemption thereunder can be availed in respect of investment made in **one residential house** situated in India. It would be more beneficial for Mr. Hari to claim exemption in respect of the Delhi house since the cost of the same is higher than the cost of the Chennai house.

Question 5

Mrs. Priya, a resident individual, sold on 30-6-2016, depreciable assets held for more than 36 months and invested the proceeds on 30-9-2016 in a residential house property to claim exemption from capital gains. Examine the validity of the order of the Assessing Officer in denying her the exemption under section 54F of the Income-tax Act, 1961. Mrs. Priya does not own any other residential house.

Answer

Exemption under section 54F would be available where an individual or HUF transfers a long-term capital asset, other than residential house, and purchases one residential house within one year before or two years after the date of transfer. Another condition to be satisfied for availing the benefit of exemption is that the individual/HUF should not own more than one residential house (other than the new residential house purchased) on the date of transfer of the original asset.

The deeming fiction created by section 50 that the capital gain arising on transfer of a depreciable asset shall be treated as capital gain arising on transfer of short-term capital asset is only for sections 48 and 49 and not for the purpose of any other section.

Section 54F being an independent section will not be bound by the provisions of section 50. The nature of capital asset, whether short-term or long-term, has to be determined applying the provisions of section 2(42A). The depreciable asset, if held for more than 36 months, shall be a long-term capital asset.

It was so held by the Delhi High Court in the case of *CIT vs. Rajiv Shukla (2011) 334 ITR 138* following the decision of Bombay High Court in the case of *CIT vs. Ace Builders Pvt. Ltd.(2006) 281 ITR 210*.

In this case, since a depreciable asset held for more than 36 months is transferred and the proceeds are invested within a span of 3 months (i.e., within the prescribed time limit of two years after the date of transfer) in a residential house property, exemption under section 54F cannot be denied to Mrs. Priya.

Mrs. Priya does not own any other residential house. Hence, she also satisfies the condition of not owning more than one residential house on the date of transfer.

Therefore, the action of the Assessing Officer in denying her exemption under section 54F is not valid.

Question 6

The proprietary firm of "Mr. Amolak" a practicing Chartered Accountant, was converted into partnership on 01.09.2016 when his son joined him in the firm for 50% share. All the assets and liabilities of the erstwhile proprietary firm were transferred into the newly constituted partnership firm.

"Mr. Amolak" was credited and paid an amount of ₹ 5 lacs in his account from the firm. Explain as to chargeability of this amount of ₹ 5 lacs in the hands of "Mr. Amolak" when it stands paid for:

(i) transfer of business into partnership;

(ii) goodwill by the incoming partner.

Answer

(i) If the amount was paid for transfer of business / profession to partnership

As per section 45(3), the profits and gains arising from the transfer of a capital asset by a person to the firm in which he becomes a partner shall be chargeable to tax as the income of the previous year which such transfer takes place. The amount recorded in the books of account of the firm would be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset.

Since in this case, consideration of ₹ 5 lacs **is received for such transfer**, profit or gain accrues to the transferor for the purposes of section 45. The amount of ₹ 5 lacs would be the full value of consideration received as a result of transfer and the capital gains resulting from this transfer would be chargeable to tax.

(ii) If the amount is paid by the incoming partner for Goodwill

The Supreme Court, in *CIT v. B.C. Srinivasa Setty (1981) 128 ITR 294*, observed that the income chargeable to capital gains tax is to be computed by deducting from the full value of consideration "the cost of acquisition of the capital asset". If it is not possible to ascertain the cost of acquisition, then, transfer of such asset is not chargeable to tax.

Section 55(2)(a) provides that the cost of acquisition of certain self-generated assets, including goodwill of a business, is Nil. Therefore, in respect of these self-generated assets covered under section 55(2)(a), the decision of the Supreme Court in *B.C. Srinivasa Setty's* case would not apply. However, in respect of other self-generated assets, including goodwill of profession, the decision of the Supreme Court in *B.C. Srinivasa Setty's case,* would continue to be applicable.

In effect, in case of self-generated assets not covered under section 55(2)(a), since the cost is not ascertainable, there would be no capital gains tax liability.

Therefore, in this case, since the consideration of ₹ 5 lakhs is paid towards goodwill of a profession, whose cost is **NOT** to be taken as 'Nil' since it is not covered under section 55(2)(a), the liability to capital gains tax will not arise.

Question 7

A resident woman individual sold a house property on 16.01.2017. On the said transaction, she earned a long-term capital gain of ₹ 1,01,50,000. She invested a sum of ₹ 50,00,000 in capital gains bonds specified in section 54EC on 05.03.2017. She further invested a sum of ₹ 50,00,000 in the same bonds on 05.05.2017. Her other income for the financial year 2016-17 was ₹ 56,000. Compute the tax payable by her for the A.Y. 2017-18.

Answer

Computation of taxable income for the A.Y. 2017-18

	Particulars	**₹**
A	Long term capital gains	1,01,50,000
	Less: Deduction under section 54EC **[See Notes 1 & 2 below]**	50,00,000
	Long term capital gain	51,50,000
B	Other income	56,000
	Total Income	**52,06,000**

As per section 112, in case of an individual, being a resident where her total income includes long-term capital gain and other income, the tax payable on the total income is the aggregate of the amount of income tax on long-term capital gains@ 20% and the amount of income tax on the total income as reduced by the amount of long term capital gain, had the total income so reduced been her total income.

However, the unexhausted basic exemption limit can be exhausted against long-term capital gains, and tax would be leviable on the balance long-term capital gains @ 20%. Therefore, the basic exemption limit of ₹ 2,50,000 should be first adjusted against other income of ₹ 56,000 and the unexhausted basic exemption limit of ₹ 1,94,000 should be adjusted against the long-term capital gains of ₹ 51,50,000. The balance long-term capital gains of ₹ 49,56,000 would be taxable@20% plus education cess@2% and secondary and higher education cess@1%. Therefore, the tax payable by the assessee would be ₹ 10,20,936.

Notes:

(1) In order to claim exemption under section 54EC, the assessee has to invest in specified bonds of RECL or NHAI within a period of 6 months from the date of transfer of the asset.

(2) However, investments made in such bonds by an assessee during any financial year cannot exceed ₹ 50 lacs.

Further, second proviso to section 54EC(1) also provides that the investment made by an assessee in bonds of NHAI/RECL, out of capital gains arising from transfer of one or more original assets, during the financial year in which the original asset or assets are transferred and in the subsequent financial year should not exceed fifty lakh rupees.

In this case, the assessee has invested ₹ 50 lacs in the F.Y.2016-17 and ₹ 50 lacs in the F.Y.2017-18, both within six months from the date of transfer. However, since the amount of investment made during the financial year in which asset transferred and in the subsequent financial year cannot exceed ₹ 50 lacs, she is eligible to claim exemption of only ₹ 50 lacs under section 54EC.

Question 8

Richie Rich Real Estates, a partnership firm engaged in real estate business, sold a land for ₹ 50 lacs on 01-06-2016. The buyer was a stranger to the assessee firm. The valuation adopted by the stamp valuation authority was ₹ 60 lacs. The Assessing Officer wants to adopt the value of ₹ 60 lacs for computing the profit arising from the sale of land, by invoking the provisions of section 50C. Is the same justified?

Answer

Section 50C(1) enjoins that where the consideration received or accruing as a result of the **transfer by an assessee of a capital asset**, being land or building or both, is less than the value adopted or assessed or assessable by the "stamp valuation authority" for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall for the purposes of section 48, be deemed to be the full value of the consideration received or accruing as a result of such transfer.

In *CIT v. Thiruvengadam Investments Private Limited (2010) 320 ITR 345 (Mad.)*, the issue under consideration was whether the provisions of section 50C are applicable where the property is held as a business asset.

The High Court pointed out that it was not in dispute that the assessee was engaged in real estate business. As the property in the hands of the assessee was treated as a business asset and not as a capital asset, there is no question of invoking the provisions of section 50C. Section 50C pertains to determining the full value of consideration of a capital asset.

However, the Assessing Officer can invoke the provisions of section 43CA, which provides that where the consideration for transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head 'Profits and gains of business or profession.

Therefore, the Assessing Officer can invoke the provisions of section 43CA to adopt the value of ₹ 60 lacs for computing the profit arising on sale of land.

Question 9

Kala purchased a residential flat from her friend Bala at ₹ 10 lacs in the city of Jaipur on 3rd October, 2016. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to ₹ 15 lacs. Bala had purchased the flat on 1st January, 2014 at a cost of ₹ 3.50 lacs. Kala sold the flat for ₹ 20 lacs on 30th March, 2017.

Determine the effect of the above transactions on the assessments of Bala and Kala for assessment year 2017-18, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration.

Answer

Tax treatment in the hands of the seller, Mr. Bala

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

In the instant case, Bala sold the residential flat at Jaipur to his friend Kala for ₹ 10 lacs, whereas the stamp duty value was ₹ 15 lacs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Therefore, short-term capital gain arising to Bala for assessment year 2017-18 will be ₹ 11.50 lacs (i.e. ₹ 15 lacs - ₹ 3.50 lacs).

Tax treatment in the hands of the buyer, Ms. Kala

The taxability provisions under section 56(2)(vii), includes within its scope, any immovable property, being land or building or both, received for inadequate consideration by an individual or HUF.

As per section 56(2)(vii), where any immovable property is received for a consideration which is less than the stamp duty by an amount exceeding ₹ 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the recipient (Individual/HUF) as the income from other sources. The provisions of section 56(2)(vii) would be attracted in this case, since the difference exceeds ₹ 50,000. Therefore, ₹ 5 lacs, being the difference between the stamp duty value of the property (i.e., ₹ 15 lacs) and the actual consideration (i.e., ₹ 10 lacs) would be taxable in the hands of Ms. Kala, under the head 'Income from Other Sources'.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(vii). Accordingly ₹ 15 lacs would be taken as the cost of acquisition of the flat. Therefore, on sale of the flat by Ms. Kala, ₹ 5 lacs (i.e. ₹ 20 lacs – ₹ 15 lacs) would be chargeable to tax as short-term capital gains in her hands for A.Y. 2017-18. Since this is a case covered by section 49(4) and not section 49(1), the period of holding of the previous owner, namely, Bala, will NOT be considered for determining whether the capital gain in short term or long term.

Question 10

On 15.11.2016, Ram gave power of attorney and possession to Rahim in respect of a vacant land acquired 10 years ago. The sale deed was executed in April, 2017. In which assessment year, the capital gain is chargeable to tax?

Answer

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or **assessable** shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

Explanation 2 below section 50C(2) defines the term 'assessable' to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

The term "assessable" brings transfers executed through power of attorney within the scope of section 50C.

Thus, when the power of attorney is executed by Ram and possession is given in favour of Rahim, the transfer is chargeable to capital gains. The capital gains is, therefore, chargeable to tax in the A.Y.2017-18.

Question 11

Can reference be made to the Valuation Officer under section 55A of the Income-tax Act, 1961 where the Assessing Officer is of the view that in the context of computation of capital gains, the value of the asset as on 1.4.1981 adopted by the assessee is more than the fair market value?

Answer

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to the Valuation Officer with a view to ascertain the fair market value of the capital asset for the purpose of computation of income under the head capital gain, in a case where the value of asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, and the Assessing Officer is of the opinion that the value so claimed is **at variance** with the fair market value of the asset.

Therefore, the Assessing Officer can make a reference to the Valuation Officer for valuation of the capital asset in a case where the fair market value of the asset as on 1.04.1981 is taken as the cost of the asset and he is of the view that there is a **variance** between the value as on 1.04.1981 claimed by the assessee in accordance with the estimate made by a registered valuer and the fair market value of the asset on that date.

Question 12

Discuss whether the benefit of exemption under section 54EC would be available in the following cases –

(a) Capital gains on transfer of depreciable assets; and

(b) Deemed capital gains on amount received on liquidation of a company.

Answer

(a) Section 54EC provides for exemption of capital gains arising from the transfer of a **long-term capital asset**, if such capital gains are invested, within a period of 6 months after the date of such transfer, in bonds of National Highways Authority of India or Rural Electrification Corporation Ltd., redeemable after 3 years. It may be noted that section 54EC provides for exemption of capital gains arising from the transfer of long-term capital asset.

By virtue of section 50, capital gain on transfer of a depreciable asset shall be treated as capital gain on transfer of short-term capital asset for the purpose of sections 48 and 49. Section 50 nowhere says that, for the purpose of section 54EC, the depreciable asset would be a short-term capital asset. Further, section 54EC is an independent section and section 50 does not have an overriding effect over section 54EC. Section 54EC has an application where a long-term capital asset is transferred. Therefore, capital gains on transfer of a depreciable asset held for more than 36 months would be eligible for benefit of exemption under section 54EC, if the conditions stipulated therein are fulfilled.

This view was upheld by the Bombay High Court in *CIT v. ACE Builders (P.) Ltd. (2006) 281 ITR 210* and the Gauhati High Court in *CIT v. Assam Petroleum Industries (P.) Ltd. (2003) 262 ITR 587* in relation to erstwhile section 54E. The Courts held that the deeming fiction created under section 50 is restricted only to the mode of computation of capital gains contained in sections 48 and 49 and does not extend to the exemption provisions.

Thus, exemption under section 54EC cannot be denied to the assessee on account of the fiction created in section 50 and shall be available on depreciable asset in case they are held for more than 36 months.

(b) The primary condition to be satisfied for claim of benefit under section 54EC is that there should be transfer of a capital asset. Section 46(1) clearly states that when assets are transferred by way of distribution to the shareholders of a company on account of liquidation, such distribution shall not be regarded as transfer in the case of a company.

However, capital gains would be chargeable to tax in the hands of the shareholders under section 46(2). Since there is no transfer in respect of cases covered by section 46, the assessee would not be entitled to the benefit of section 54EC. This was held by the Rajasthan High Court in *CIT v. Ruby Trading Co. (P) Ltd. (2003) 259 ITR 54*, in relation to erstwhile section 54E. The rationale of the decision can be extended to section 54EC and consequently, the assessee would not be entitled to benefit of section 54EC since there is no transfer in respect of cases covered by section 46.

Note: *However, in case a view is taken that on liquidation of a company, the shareholders right in the said company is relinquished or extinguished and the consideration received by the shareholder is for such relinquishment or extinguishment of rights of the shareholder, then, this transaction shall be transfer as per section 2(47), in which case, exemption under section 54EC in respect of the capital gain arising from the said transaction would be available.*

Question 13

Anish owns a residential house which is self-occupied and also a house plot. He sells the house on 28.2.2017 and the house plot on 4.3.2017 for ₹ 18 lacs and ₹ 12 lacs, respectively. The house was purchased on 17.10.2000 for ₹ 4.5 lacs and the plot on 26.12.1999 for ₹ 3 lacs. Anish has purchased a new residential house on 3.5.2017 for ₹ 10 lacs. Compute the income chargeable under the head "Capital Gain" for the A.Y. 2017-18. Cost inflation indices for the financial year 1999-2000, 2000-2001 and 2016-17 are 389, 406 and 1125, respectively.

Answer

Computation of Capital Gains of Anish for the A.Y.2017-18

Particulars	₹
Sale of house on 28.2.2017	
Sale consideration received	18,00,000
Less: Indexed cost of acquisition ₹ 4,50,000 x 1125/406	12,46,921
Long term capital gain	5,53,079
Less: Exemption under section 54 (lower of capital gains or amount invested)	5,53,079
Taxable capital gain	**Nil**
Sale of house plot on 4.3.2017	
Sale consideration received	12,00,000
Less: Indexed cost of acquisition ₹ 3,00,000 x 1125/389	8,67,609
Long term capital gain	3,32,391
Less: Exemption under section 54F	
Investment for the purpose of section 54F is ₹ 4,46,921 (i.e. ₹ 10,00,000 – ₹ 5,53,079), which is less than the net consideration on	

sale of plot. Therefore, only proportionate capital gain would be exempt under section 54F. [Capital gain × Amount invested / Net sale consideration] i.e., [₹ 3,32,391 × ₹ 4,46,921 / ₹ 12,00,000]	1,23,794
Taxable capital gain	**2,08,597**

Question 14

Mr. Ganesh sold his residential house in Mumbai and purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase of one residential house only and the two flats cannot be treated as one residential unit since –

(i) the flats were purchased through different sale deeds; and

(ii) it was found by the Inspector that, before its sale to the assessee, the residential flats were in occupation of two different tenants.

Discuss the correctness of the contention of the Assessing Officer.

Answer

This issue came up before the Karnataka High Court in *CIT v. D. Ananda Basappa (2009) 309 ITR 329*. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form **one residential house**. Therefore, the contention of the Assessing Officer is not correct.

Question 15

3 Star & Company, a partnership firm, entered into a contract to purchase an immovable property. The agreement was not honoured by the seller. 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 3-Star & Company ₹ 15 *lacs as consideration. State with reasons whether the receipt should be treated to be in the nature of capital gain in the hands of the firm.*

Answer

The assessee, 3-Star & Company, entered into a contract to buy an immovable property. On failure on the part of the seller, the assessee filed a suit for specific performance of the contract. Subsequently, the assessee received ₹ 15 lacs from owner in terms of a compromise agreed to by the parties.

In the case of *CIT v. Smt. Laxmidevi Ratani (2008) 296 ITR 363 (MP),* the High Court, on identical facts, held that the receipt is exigible to capital gains tax as it involved transfer of property within the meaning of section 2(47). The action on the part of the assessee in giving up its right to claim the property and instead accepting money compensation is a clear case of extinguishment of right in the property resulting in transfer as defined in section 2(47).

Question 16

Aerochem, a partnership firm, transfers a piece of land situated in Thane district on 17.8.2016 for ₹ 70 lacs. The land, purchased on 6.3.1980 for ₹ 1 lac, was registered on 3.4.1984 on payment of stamp duty of ₹ 20,000. Expenses on land development and construction of boundary wall incurred in August, 1984 were of ₹ 1,50,000. The charges for the transfer of land paid to the broker were 2½% of the sale consideration. Fair market value of the land as on 1.4.1981 was ₹ 1,50,000.

The firm invested ₹ 30 lacs on 1.12.2016 in the bonds issued by National Highways Authority of India redeemable after 3 years. Compute the amount of capital gain chargeable to tax for Assessment Year 2017-18 with the help of cost inflation index for F.Y. 1984-85 and F.Y. 2016-17 of 125 and 1125, respectively. Also, give in brief, the reasons and the applicable provisions for each of the items dealt with.

Answer

Computation of Capital Gains chargeable to tax for A.Y.2017-18

Particulars	₹	₹
Gross sale consideration of the land		70,00,000
Less: Expenses on transfer of land paid to a broker @ 2.5% of the sale value **[See Note 1]**		1,75,000
Net Sale Consideration		68,25,000
Less: Indexed cost of acquisition and improvement		
A) ₹ 1,50,000 x 1125/100 **[See Notes 2 & 4]**	16,87,500	
B) ₹ 1,70,000 x 1125/125 **[See Notes 3 & 4]**	15,30,000	32,17,500
		36,07,500
Less: Investment in bonds of NHAI eligible for exemption under section 54EC **[See Note 5]**		30,00,000
Capital Gain		**6,07,500**

Notes:

(1) Brokerage paid is allowable as deduction under section 48(i) as held by Rajasthan High Court in the case of *Sah Roop Narain vs. CIT (1987) 32 Taxman 453*.

(2) Cost of acquisition of the capital asset can be claimed as deduction under section 48 while computing capital gains. As per section 55(2)(b)(i), the cost of acquisition in case of a capital asset acquired before 1.4.1981 shall be the actual cost of acquisition or the fair market value as on 1.4.1981, at the option of assessee. Accordingly, in this case, the cost of acquisition would be the fair market value of the land on 1.04.1981, as the same is more beneficial to the assessee.

(3) Cost of improvement of the capital asset can also be claimed as deduction under section 48. The cost of improvement, in this case, would include the expenditure of ₹ 1,50,000 on land development and construction of boundary wall and expenditure of ₹ 20,000 on payment of stamp duty. Therefore, the total cost of improvement would be ₹ 1,70,000.

(4) Since the asset transferred is a long-term capital asset, indexation benefit would be available and the indexed cost of acquisition and indexed cost of improvement are allowable as deduction while computing capital gains.

(5) Under section 54EC, exemption is available for investment, made within a period of 6 months from the date of transfer, in bonds of NHAI or RECL, redeemable after 3 years. In this case, the transfer took place on 17.8.2016 and the investment was made in bonds of NHAI, redeemable after 3 years, on 1.12.2016, which is within the 6 month period. Therefore, the investment of ₹ 30 lacs qualify for exemption under section 54EC.

Question 17

(a) Discuss whether the following can be treated as transfer of capital asset for the purpose of levy of capital gains tax:

(i) Transfer of house property in a transaction of reverse mortgage.

(ii) Conversion of foreign currency bonds into shares.

(b) Examine the correctness of the following statement:

Section 2(14) of the Act excludes all items of movable property which are held for personal use of the assessee or any member of his family.

Answer

(a) (i) Clause (xvi) of section 47 provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to a transfer for the purpose of capital gains. Therefore, transfer of house property in a transaction of reverse mortgage will not be treated as a transfer of capital asset for the purpose of capital gains.

(ii) Clause (x) of section 47 provides that conversion of, *inter alia,* bonds of a company into shares of that company would not amount to a transfer for levy of capital gains tax. Foreign Currency Convertible Bonds (FCCBs) fall within the ambit of this clause. Clause (xa) of section 47 provides that the conversion of Foreign Currency Exchangeable Bonds (FCEBs) into shares or debentures of any company shall not be treated as a 'transfer'. The difference between FCCBs and FCEBs is that whereas FCCBs can only be converted into shares of the issuing company, FCEBs can also be converted into or exchanged for the shares of a group company.

(b) Sub-clause (ii) of section 2(14) provides that personal effects, that is, movable property including wearing apparel and furniture held for the personal use by the assessee or any member of his family dependent on him are not capital assets. However, the following movable property held for the personal use by the assessee or any member of his family dependent on him are capital assets -

(a) jewellery; (b) archaeological collections; (c) drawings; (d) paintings;

(e) sculptures; or (f) any work of art.

Hence, the statement "Section 2(14) of the Act excludes all items of movable property which are held for personal use of the assessee or any member of his family" is incorrect.

Question 18

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961 for A.Y. 2017-18:

A farmer (resident of Jaipur) sold his rural agricultural land situated in Nepal and received Indian Rupees 2 lacs over the cost of acquisition of this land.

Answer

The definition of capital assets under section 2(14) specifically excludes rural agricultural land in India. Therefore, it follows that if such land is situated outside India, it would fall within the definition of capital asset under section 2(14). Accordingly, capital gains on sale of rural agricultural land situated in Nepal would be subject to tax in the hands of the farmer, since he is a resident in India.

Question 19

A shareholder of a demerged Indian company received listed shares from the resulting company in the scheme of demerger. The shareholder wants to transfer the said shares received subsequent to the demerger for consideration. Your advice is sought on the tax consequences as to the shares received on demerger and sought to be transferred.

Answer

As per the provisions of section 47(vid), any transfer or issue of shares by the resulting company to the shareholders of the demerged company in a scheme of demerger is not regarded as a transfer for the purposes of capital gains under section 45, if the transfer or issue is made in consideration of the demerger of the undertaking.

As a consequence of the demerger, the existing shareholders of the demerged company will receive shares in a resulting company. When the shareholder subsequently intends to transfer the said shares, the cost of such shares will have to be arrived at as per the provisions of section 49(2C). According to the said provision, the cost of acquisition of shares in the resulting company will be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

As per the provisions of section 2(42A)(g), for determining the period of holding of such shares, the period for which the shares of the demerged company were held by the assessee would also be considered.

If the listed shares are held for more than one year, and transferred through a recognized stock exchange and securities transaction tax has been paid on such sale, the long-term capital gain arising therefrom would be exempt under section 10(38). If the total holding period does not exceed one year, then the short-term capital gains arising on sale of such shares would be taxable @15% under section 111A.

Question 20

Sri Sajjan converted the capital asset, acquired by him in the year 1989, into stock-in- trade at the fair market value on 1st March, 2016. Sri Sajjan sold the entire stock-in-trade so converted, on 25th November, 2016. Sri Sajjan seeks your advice as to the tax implications of the transaction with reference to the provisions of Income-tax Act, 1961 for the assessment year 2017-18.

Answer

Conversion of a capital asset into stock-in-trade falls within the definition of transfer under section 2(47). Therefore, in this case, transfer has taken place during the previous year 2015-16.

However, as per section 45(2), the capital gains liability arises only in the year in which the stock-in-trade is sold i.e. previous year 2016-17, in this case. It is a long-term capital gain since the asset was acquired in 1989. The fair market value (FMV) on the date of conversion i.e. on 1.3.2016 is deemed to be the full value of consideration accruing as a result of transfer of the capital asset.

Therefore, in the year of sale of stock-in-trade (i.e. P.Y. 2016-17), both business income and capital gains would arise. Where,

Business income = Sale consideration of stock-in-trade – FMV on the date of conversion
Capital gains = FMV on the date of conversion – Indexed cost of acquisition / improvement

Question 21

A piece of land owned by Mr. Mishra located on Jaipur-Delhi highway was acquired by NHAI in the F.Y.2008-09, but the award ordered in F.Y. 2009-10 was paid in the F.Y. 2016-17. This land was purchased by him on 2.4.1978 for ₹ 10,000. The fair market value of the land as on 1.4.1981 was ₹ 9,000. Compensation paid was ₹ 20 lacs.

The other piece of land located in Chennai purchased in April, 2004 for ₹ 25 lacs was also sold by him in February, 2017 for ₹ 35 lacs, but sale deed thereof could not be executed by 31.3.2017. The value for the purpose of stamp duty to be applied by the stamp valuation authority was ₹ 40 lacs.

Compute the income chargeable to tax arising as a result of these transactions in the A.Y.2017-18. The CIIs for the F.Y: 2004-05, 2008-09, 2009-10 and 2016-17 are 480, 582, 632 and 1125 respectively.

Answer

Computation of taxable income of Mr. Mishra for A.Y.2017-18

Particulars	₹
Capital Gains	
(A) Long-term capital gain derived from transfer of land on Jaipur-Delhi highway acquired by NHAI in F.Y. 2008-09 for which award was paid in F.Y. 2016-17 is chargeable to tax in A.Y.2017-18 **[See Note (i) below]**	
Sale consideration i.e. compensation paid	20,00,000
Less: Indexed cost of acquisition **[See Note (ii) below]** $\frac{(10000 \times 582)}{100}$	58,200
Long Term Capital Gains (A)	**19,41,800**
(B) Sale of land at Chennai in February 2017 **[See Note (iii) below]**	
Full value of consideration as per section 50C **[See Note (iv) below]**	40,00,000
Less: Indexed cost of acquisition (₹ 25,00,000 × 1125/480)	58,59,375
Long Term Capital Loss (B)	**(18,59,375)**
Long Term Capital Gains (A - B)	**82,425**

Total income chargeable to tax arising as a result of these transactions in the A.Y.2017-18 is equal to ₹ 82,425 (i.e. ₹ 19,41,800 - ₹ 18,59,375). Long term capital loss can be set-off from the long term capital gain.

Notes:

(i) The capital gains arising on compulsory acquisition shall be charged to tax in the year in which the compensation is first received as per section 45(5)(a).

(ii) The option of fair market value as on 1.4.1981 is not exercised by the assessee since the fair market value is lower than the cost.

582 is the cost inflation index of F.Y.2008-09 i.e. the year in which the property was compulsorily acquired.

(iii) The execution of sale deed is not compulsory for the purpose of charge of capital gain because the transfer of right enabling enjoyment of immovable property gives rise to charge of capital gains as held by the Kerala High Court in the case of *CIT v. C.F. Thomas (2006) 284 ITR 557.*

(iv) As per section 50C, the value applied by the stamp valuation authority is deemed to be the full value of consideration received or accruing as a result of such transfer, since such value is higher than the sale consideration of ₹ 35 lacs. 1125 is the cost inflation index of F.Y.2016-17 i.e., the year in which the property at Chennai was sold.

Question 22

Vijay, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2017-18. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of Vijay for a monetary consideration.

Vijay utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. Vijay is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes.

Is Vijay eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2017-18 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the non-use of the new house for his own residential purposes disentitle him to exemption?

Answer

The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, *inter alia*, for purchase of one residential house situated in India within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of Vijay would amount to "purchase" by Vijay for the purpose of claiming exemption under section 54 *[CIT v. T.N. Arvinda Reddy (1979) 120 ITR 46 (SC)].* Since such purchase is within the stipulated time of two years from the date of transfer of asset, Vijay is eligible for exemption under section 54. As Vijay has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

There is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes and its income is chargeable under the head "Income from house property". This requirement would be satisfied even when the new house is let out for residential purposes.

Question 23

Sanjay, an individual, purchased a site on 21.4.2003 for ₹ 2,00,000. He completed construction of a building thereon on 14.2.2013 at a cost of ₹ 10,00,000. He sold the property consisting of site and building on 7.12.2016 for ₹ 20,00,000. Sanjay seeks your opinion on the nature of capital gain arising to him from the sale of the property for the A.Y.2017-18.

Computation of capital gain is not necessary.

Answer

Site and building are separate capital assets for the purpose of capital gains. This distinction is clear from the scheme of the Income-tax Act, 1961. For the purpose of section 32, a building which is entitled to depreciation means only the superstructure and does not include the site on which it is built. This was held by the Apex Court in *CIT v. Alps Theatre (1967) 65 ITR 377*.

In this case, the site is a long-term capital asset since it is held by Sanjay for more than 36 months and the building is a short-term capital asset since it is held by Sanjay for less than 36 months. The site is an independent capital asset and continues to be so even after the construction of the building thereon. Even though the property consisting of site and building was sold as a single asset for a consolidated price of ₹ 20,00,000, such price can be attributed to the site and building separately.

Therefore, in the case of Sanjay, the capital gain attributable to the site is assessable as long-term capital gain and the capital gain attributable to the building is assessable as short-term capital gain for the assessment year 2017-18.

Question 24

(i) John inherits a house property from his father, who had mortgaged it. John discharges the mortgage debt. John later sells the property. Can he claim the amount paid to the mortgagee as cost of improvement in computing the capital gain?

(ii) Laxman 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?

Answer

(i) John inherited the house property with the liability to discharge the mortgage debt. He can, therefore, claim the amount paid to the mortgagee as cost of improvement/acquisition while computing the capital gain on sale of the said property. The decision of the Supreme Court in *RM. Arunchalam v. CIT (1997) 227 ITR 222* supports this view.

(ii) Laxman has himself created the mortgage in respect of his house property. It is a self-created mortgage. Therefore, the debt discharged by Laxman on the property under mortgage created by him does not form part of cost of acquisition. The decision of the Supreme Court in *V.S.M.R. Jagadish Chandran v. CIT (1997) 227 ITR 240* supports this view. Therefore, capital gain on sale of the property cannot be computed on the basis of the claim made by him.

Note – *This question can also be answered with reference to the Bombay High Court ruling in CIT v. Roshanbabu Mohammed Hussein Merchant (2005) 275 ITR 231. This case highlights the difference in tax treatment in respect of allowability of the expenditure incurred on removing an encumbrance in two different cases, namely –*

(i) In a case where the mortgage is created by the previous owner and

(ii) In a case where the mortgage is created by the assessee himself.

The Bombay High Court pointed out that there is a distinction between the obligation to discharge the mortgage debt created by the previous owner and the obligation to discharge the mortgage debt created by the assessee himself. Where the property acquired by the assessee is subject to the mortgage created by the previous owner, the assessee acquires absolute interest in that property only after the discharge of mortgage debt. In such a case, the expenditure incurred by the assessee to discharge the mortgage debt created by the previous owner to acquire absolute interest in the property is treated as 'cost of acquisition' and is deductible from the full value of consideration received by the assessee on transfer of that property. However, where the assessee acquires property which is unencumbered, the assessee gets absolute interest in that property on acquisition. When the assessee transfers that property, he is liable for capital gains tax on the full value realized, even if he has himself created an encumbrance on that property. The assessee is under an obligation to remove that encumbrance for effectively transferring the property. In other words, the expenditure incurred by the assessee to remove the encumbrance created by the assessee himself on the property (which was acquired by him without any encumbrance) is not an allowable deduction under section 48.

Question 25

State the cases where the benefit of indexation of costs is not available for determination of capital gains.

Answer

In the following cases, the benefit of indexation of cost is not available for determination of capital gains on transfer of capital assets –

1. Transfer of capital assets held for not more than 36 months (12 months in the case of listed securities, etc), since capital gains arising therefrom would be a short term capital gains.

2. Transfer of depreciable assets where computation is governed by section 50, since capital gains arising therefrom would always be short term capital gains, even if they are held for more than 36 months.
3. Transfer of undertaking or division in a slump sale under section 50B.
4. Transfer of bonds/debentures other than capital indexed bonds issued by the Government *(Third proviso to section 48)*.
5. Transfer of shares in or debentures of an Indian company, acquired by a non-resident in foreign currency *(First and second proviso to section 48)*.
6. Transfer of a foreign exchange asset by a non-resident Indian, who opts to be governed by the provisions of Chapter XII-A *(Section 115D)*.
7. Transfer of Global Depository Receipts purchased in foreign currency by an individual resident in India and employee of an Indian company or its subsidiary engaged in specified knowledge based industry or service *(Section 115ACA)*.
8. Transfer of units of Unit Trust of India or a Mutual Fund specified under section 10(23D) purchased in foreign currency by an overseas financial organisation referred to as Offshore Fund *(Section 115AB)*.
9. Transfer of securities by Foreign Institutional Investors *(Section 115AD)*.

Question 26

Redemption of preference shares amounts to "transfer" within the meaning of section 2(47) of the Income-tax Act, 1961 in the hands of the shareholder. Discuss.

Answer

The definition of the term "transfer" under section 2(47) is not an exhaustive definition but an inclusive one. "Transfer" in relation to capital asset includes, *inter alia*, sale, exchange or relinquishment of capital asset.

When shares are redeemed by a company, it only means that the concerned shareholder is giving up his or her ownership or claim with reference to the shares in favour of the company. The consideration received by the shareholder from the company is certainly for sale/relinquishment of the interest in the shares and therefore, the redemption of preference shares amounts to "transfer" and the gain arising therefrom, being the excess realization over the cost of acquisition, shall be charged to tax under the head "Capital Gains". This was upheld by the Supreme Court in *Anarkali Sarabhai vs CIT (1997) 224 ITR 422*. If the redemption is after a period of 12 months from the date of acquisition of shares by the shareholder, the long term capital gain shall be computed by deducting the indexed cost of acquisition. The resultant long term capital gain shall be charged to tax in accordance with the provisions of section 112.

Question 27

Aries Tubes Private Ltd. went into liquidation on 01.06.2016. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	₹
Share Capital (issued on 01.04.2012)	*5,00,000*
Reserves prior to 1.6.2016	*3,00,000*
Excess realization in the course of liquidation	*5,00,000*
Total	***13,00,000***

There are 5 shareholders, each of whom received ₹ 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital 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.

Answer

Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, the accumulated profits immediately before liquidation is ₹ 3,00,000. The share of each shareholder is ₹ 60,000 (being one-fifth of ₹ 3,00,000). An amount of ₹ 60,000 is the deemed dividend under section 2(22)(c). The same is 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, ₹ 2,00,000 [i.e. ₹ 2,60,000 minus ₹ 60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of ₹ 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of ₹ 1,00,000 of each shareholder. 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. Since the equity shares are not listed, it would not be liable for securities transaction tax and hence, the capital gain (long term) is not exempt under section 10(38). The benefit of concessional rate of tax @10% without indexation would also not be available. Hence, such long term capital gain would be taxable @ 20% with indexation benefit.

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 relinquished or extinguished and the consideration received by the shareholder is for such relinquishment or extinguishment of rights of the shareholder, then, this transaction shall be transfer as per section 2(47) and the exemption under section 54EC in respect of the capital gain arising from the said transaction shall be available.*

Question 28

Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.03.1981 for ₹ 5 lacs. The said property was inherited by his son Abraham in financial year 2008-09 as per Will.

For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.02.2009 of ₹ 15 lacs. The said house property was sold by Abraham on 16.03.2017 for ₹ 50 lacs. State with reasons the amount chargeable to capital gains for A.Y. 2017-18

(Cost Inflation Index 2008-09: 582 and 2016-17: 1125).

Answer

The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iiia) and therefore, ₹ 5 lacs, being the cost to his father (amount paid by his father on 26.3.1981 for acquiring the property) shall be the cost to Mr. Abraham, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of *RM. Arunachalam v. CIT [1997] 227 ITR 222.*

Computation of Taxable Capital Gain for the A.Y. 2017-18

Particulars		₹
Sale consideration of house property		50,00,000
Less: **Indexed cost of acquisition (See Note below)**		
(i) Cost to previous owner (₹ 5,00,000 × 1125 / 582)	9,66,495	
(ii) Loan amount paid by Mr. Abraham (Benefit of CII is available since the loan amount was paid in the financial year 2008-09) (₹ 15,00,000 × 1125/582)	28,99,485	38,65,980
Capital gains		**11,34,020**

Note: Since the property was acquired by Mr. Abraham through inheritance, the cost of acquisition will be cost to the previous owner.

As per the definition of indexation cost of acquisition under clause (iii) of *Explanation* below section 48, indexation benefit will be available only from the previous year in which Abraham first held the asset i.e. P.Y. 2008-09.

However, as per the view expressed by Bombay High Court, in the case of *CIT v. Manjula J. Shah (2013) 355 ITR 474,* in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would be ₹ 85,24,485 and long term capital loss would be ₹ 35,24,485.

Question 29

'X', purchased on 18.6.2003, house property for ₹ 22,00,000 which was sold to A on 18.10.2016 for ₹ 38,75,000. The sub-registrar, at the time of registration of sale deed, charged stamp duty on ₹ 60,00,000 which was paid by the buyer.

The Assessing Officer while assessing for capital gain referred the matter to the valuation officer as per the request of vendor. The Valuation Officer determined the value of property at ₹ 55,00,000 on the date of transfer. X seeks your advice on the following:

(i) On what value the Assessing Officer could compute capital gain chargeable to tax?

(ii) The amount of capital gain on which 'X' is required to pay capital gains tax. (The CII for F.Y. 2003-04 is 463 and of F.Y. 2016-17 is 1125).

Answer

(i) According to section 50C, the Assessing Officer can refer the property to the valuation officer, only when the following two conditions are satisfied:

(a) The value fixed by the stamp valuation authority is not disputed in appeal or revision etc.

(b) The assessee claims before the Assessing Officer that the value adopted or assessed by the stamp valuation authority exceeds the fair market value (FMV) of the property as on the date of transfer.

In the instant case, though the assessee paid the stamp duty as fixed by the stamp valuation authorities, he had requested the Assessing Officer to refer the property to the Valuation Officer for valuation. The value determined by the Valuation Officer is less than the value adopted by the stamp valuation authority. Therefore, such value only could be adopted for computing chargeable capital gains.

(ii) The amount on which the assessee is required to pay capital gains tax will be as under:-

Sale consideration of the house property under section 50C(1)	₹ 55,00,000
Less: Indexed cost of acquisition ₹ 22,00,000 × 1125/463	₹ 53,45,572
Long term capital gain	**₹ 1,54,428**

Question 30

Specify the items of capital assets in respect of which the cost of acquisition shall be taken as 'Nil' under the provisions of the Income-tax Act, 1961 while computing capital gains.

Answer

According to section 55 of the Income-tax Act, 1961, the cost of acquisition shall be taken to be 'nil' in the case of the following capital assets:

1. Self generated goodwill of a business
2. A trademark or brand name associated with the business.
3. Any right to manufacture, produce or process any article or thing; and
4. Right to carry on any business or profession
5. Tenancy rights
6. Stage carriage permits
7. Loom hours
8. Bonus shares
9. Right to subscribe to rights issues

Question 31

Dalal entered into an agreement with Shroff for the sale of his property and received earnest money of ₹ 1,00,000 on 1.4.2016. The balance of ₹ 4,00,000 was to be paid within 3 months, failing which, the earnest money was liable to be forfeited. Shroff defaulted in the payment of the balance within the time specified and therefore the earnest money was forfeited. Discuss the nature of the receipt from the point of view of liability to tax.

Answer

Under section 51, any advance retained or received in respect of a negotiation for transfer which failed to materialise shall be reduced from the cost of acquisition of the asset or the written down value or the fair market value of the asset, at the time of its transfer to compute the capital gains arising therefrom. In case the asset transferred is a long-term capital asset, indexation benefit would be on the cost so reduced.

However, any sum of money received on or after 1.04.2014 as an advance or otherwise in the course of negotiations for transfer of a capital asset shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited and the negotiations do not result in transfer of such capital asset. Consequently, such amount shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

Therefore, the earnest money forfeited by Dalal would be chargeable to tax under section 56(2)(ix) under the head "Income from Other Sources" for A.Y. 2017-18, since the sum was received on 01.04.2016 and forfeited on account of default in the payment of the balance within the time specified.

Question 32

Chand Ltd. decided to effect buy-back of share capital by purchase of listed shares in open market. During the year ended 31.3.2017, Chand Ltd. purchased its own 10,000 shares, listed in BSE. Discuss the tax implications in the hands of Chand Ltd. and shareholders.

Answer

Section 46A provides for the taxability of capital gains in the hands of shareholders, when the shares are purchased by the company in the open market by way of buy-back of its own listed shares. In the hands of Chand Ltd, there shall be no liability to tax as the payment is on capital account.

In the case of shareholders, the difference between the consideration received by the shareholders and the cost of acquisition will be chargeable to tax as capital gains. Any payment made by a company on purchase of its own shares in accordance with section 77A of the Companies Act, 1956 will not constitute dividend under section 2(22). Hence, there is no liability on the part of the company to deduct tax at source.

Question 33

A Manufacturing company was transporting two of its machines from unit 'A' to unit 'B' (which is at a distance of 100 miles) on 1st September, 2016 by a truck. On account of a civil disturbance, both the machines were damaged. The insurance company paid ₹ 5 lacs for the damaged machines. On these facts, for submitting the return of income for the previous year ending 31st March, 2017, your advice is sought as to:

(i) Whether the damage of machines results in any transfer?

(ii) How the amounts received from the insurance company are to be treated for taxability?

(iii) Would there be any impact on the written down value of the block of plant and machinery as at 31st March 2017?

Answer

As per section 45(1A), receipt of insurance compensation in the form of money or any asset is to be treated as consideration and capital gain is accordingly to be charged to tax. The two qualifying conditions prescribed are (a) the compensation should have been received because of damage or destruction of capital asset and (b) the damage or destruction is as a result of circumstances mentioned therein.

As per the facts of the case, both the conditions are satisfied and therefore, the compensation is to be treated as consideration. Applying section 45(1A), the answers to the issues are:

(i) in the case of damage or destruction, there is no actual transfer;

(ii) the receipt of insurance compensation of ₹ 5 lacs has to be treated as consideration in accordance with the provisions of section 45(1A).

(iii) in the instant case, as per the provisions of section 43(6)(c) the receipt of compensation of ₹ 5 lacs calls for adjustment in the written down value of the block of assets. If the written down value is more than ₹ 5 lacs, then ₹ 5 lacs should be deducted from written down value. On the other hand, if the written down value is less than ₹ 5,00,000, the difference would be treated as short term capital gain.

Question 34

Gama Ltd, located within the corporation limits decided in December, 2016 to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows: **(₹ in lacs)**

	Particulars	*Land*	*Building*	*Plant & Machinery*	*Furniture*
(i)	*Sale proceeds (sale effected in March, 2017)*	*8*	*18*	*16*	*3*
(ii)	*Indexed cost of acquisition*	*4*	*10*	*12*	*2*
(iii)	*Cost of acquisition in terms of section 50*	*--*	*4*	*5*	*2*
(iv)	*Cost of new assets purchased in July, 2017 for the purpose of business in the new place*	*4*	*7*	*17*	*2*

Compute the capital gains of Gama Ltd for the assessment year 2017-18.

Answer

Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area, within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income 'under section 45'.
2. If the total gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Capital gain arising on transfer of furniture does not qualify for exemption under section 54G. No exemption is therefore available under section 54G in respect of investment of ₹ 2 lacs in acquiring furniture.

The first step therefore is to determine the capital gain arising out of the transfer and thereafter apply the provisions of section 54G.

	Particulars	₹
(a)	**Land** – Sale proceeds (Non depreciable)	8,00,000
	Less: Indexed cost	4,00,000
	Long term capital gain	4,00,000
	Less: Cost of new assets purchased within one year before the transfer (under section 54G)	3,00,000
	Taxable Long term capital gain	**1,00,000**
(b)	**Building** – sale proceeds (depreciable assets)	18,00,000
	Less: W.D.V. is deemed as cost of acquisition under section 50	4,00,000
	Short term capital gain	**14,00,000**
(c)	**Plant & machinery-** sale proceeds (depreciable asset)	16,00,000
	Less: WDV is deemed cost under section 50	5,00,000
	Short term capital gain	**11,00,000**
(d)	**Furniture -** sale proceeds (depreciable asset)	3,00,000
	Less: WDV is deemed cost under section 50	2,00,000
	Short term capital gain **(A)**	**1,00,000**

Summary	
Short term capital gain : Building	14,00,000
Short term capital gain : Plant & machinery	11,00,000
	25,00,000
Less: Section 54G [New assets purchased] **(See Note below)**	25,00,000
Net short term capital gain **(B)**	**Nil**
Total short term capital gain (A)+(B) = ₹ 1 lac	

Note – Total exemption available under section 54G is ₹ 28 lacs (₹ 4 lacs + ₹ 7 lacs + ₹ 17 lacs). The exemption should first be exhausted against short term capital gain as the incidence of tax in case of short-term capital gain is more than in case of long term capital gain. Therefore, ₹ 25 lacs is exhausted against short term capital gain and the balance of ₹ 3 lacs against long term capital gain.

The taxable capital gains would be:

Long term capital gains	₹ 1,00,000 (taxable @ 20% under section 112)
Short term capital gains	₹ 1,00,000 (taxable @30%)
	₹ 2,00,000

Question 35

The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth ₹ 4 lacs on 1.5.2007 and insured it with United India Assurance Ltd against fire, flood, earthquake etc., The written down value of the asset as on 01.04.2016 was ₹ 2,08,800. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc., in case of destruction of loss. A fire broke out in August, 2016 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of ₹ 6 lacs from the insurance company on 15th March, 2017. Discuss the issues arising on account on the transactions and their tax treatment.

(Cost inflation index for financial year 2007-08 and 2016-17 are 551 and 1125 respectively)

Answer

As per section 45(1A), where any person receives any money or other assets under an insurance from an insurer on account of damage to or destruction of capital asset, then, any profits and gains arising form the receipt of such money or other assets, shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of such person of the previous year in which such money or asset was received.

For the purpose of section 48, the money received or the market value of the asset shall be deemed to be the full value of the consideration accruing as a result of the transfer of such capital asset. Since the asset was destroyed and the money from the insurance company was received in the previous year, there will be a liability to capital gains in respect of the insurance moneys received by the assessee.

Under section 45(1A) any profits and gains arising from receipt of insurance moneys is chargeable under the head "Capital gains". For the purpose of section 48, the moneys received shall be deemed to be the full value of the consideration accruing or arising. Under section 50 the capital gains in respect of depreciable assets had to be computed in the following manner (**assuming it was the only asset in the block**).

The computation of capital gain and tax implication is given below:

Full value of the consideration	₹ 6,00,000
Less: Written down value as on April 1st, 2016	₹ 2,08,800
Short term capital gains	₹ 3,91,200

Question 36

Tani purchased a land at a cost of ₹ 10 lakhs in the financial year 1982-83 and held the same as her capital asset till 31st March, 2010. Tani started her real estate business on 1st April, 2010 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was ₹ 150 lakhs.

She constructed 20 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 8 lakhs. Construction was completed in December, 2016. She sold 15 flats at ₹ 20 lakhs per flat between January, 2017 and March, 2017. The remaining 5 flats were held in stock as on 31st March, 2017.

She invested ₹ 50 lakhs in bonds issued by Rural Electrification Corporation Ltd. on 31st March, 2017.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2017-18 indicating clearly the reasons for treatment for each item.

Cost Inflation Index: FY 1982-83: 109; FY 2010-11: 711; FY 2016-17: 1081.

Answer

Computation of capital gains and business income of Tani for A.Y. 2017-18

Particulars	₹
Capital Gains	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	1,50,00,000
Less: Indexed cost of acquisition [₹ 10,00,000 × 711/109]	65,22,936
	84,77,064
Proportionate capital gains arising during A.Y.2017-18 [₹ 84,77,064 × ¾]	63,57,798
Less: Exemption under section 54EC	50,00,000
Capital gains chargeable to tax for A.Y.2017-18	13,57,798
Business Income	
Sale price of flats [15 × ₹ 20 lakhs]	3,00,00,000
Less: Cost of flats	
Fair market value of land on the date of conversion [₹ 150 lacs × ¾]	1,12,50,000
Cost of construction of flats [15 × ₹ 8 lakhs]	1,20,00,000
Business income chargeable to tax for A.Y.2017-18	**67,50,000**

Notes:

(1) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade.

(2) However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.

(3) The indexation benefit for computing indexed cost of acquisition would, however, be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.

(4) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

In this case, since only 75% of the stock-in-trade (15 flats out of 20 flats) is sold in the P.Y.2016-17, only proportionate capital gains (i.e., 75%) would be chargeable in the A.Y.2017-18.

(5) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be the difference between the price at which the stock-in-trade is sold and the fair market value on the date of conversion of the capital asset into stock-in-trade.

(6) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [*CBDT Circular No.791 dated 2.6.2000]*. In this case, since the investment in bonds of RECL has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC.

Question 37

Mr. Shakti purchased a residential house in March, 2002 for ₹ 22 lakhs. He sold the house on 1st December, 2016 for ₹ 100 lakhs. He paid brokerage at 2% on sale price. He invested ₹ 80 lakhs in April, 2017 in equity shares of Shakti Manufacturing Private Limited, a newly formed manufacturing company which qualifies to be a small enterprise under the Micro, Small and Medium Enterprises Development Act, 2006. Mr. Shakti holds 80% of share capital of the company.

The company utilised the sum of ₹ 80 lakhs in the following manner:

(i) Purchase of new machinery during April, 2017 ₹ 70 lakhs (including ₹ 10 lakhs for purchase of computers).

(ii) Deposit in specified bank on 25th September, 2017 ₹ 10 lakhs.

The due date for filing return of income for Mr. Shakti for Assessment Year 2017-18 is 30th September, 2017. Assume that he files the return on 28th September, 2017.

Compute the taxable capital gain arising from the above transaction for Assessment Year 2017-18. (Cost Inflation Index: FY 2001-02: 426; FY 2016-17: 1125)

Answer

Computation of taxable capital gains of Mr. Shakti for A.Y. 2017-18

Particulars	₹
Gross sale consideration	1,00,00,000
Less: Expenses on transfer (2% of the gross sale consideration)	2,00,000
Net sale consideration	**98,00,000**
Less: Indexed cost of acquisition (₹ 22,00,000 × 1125/426)	58,09,859
Long term capital gains	39,90,141
Less: Exemption under section 54GB **(See Note below)** (₹ 39,90,141 × ₹ 70,00,000 / ₹ 98,00,000)	28,50,101
Taxable capital gains	**11,40,040**

Deemed cost of new plant and machinery for exemption under section 54GB

	Particulars	₹
(1)	Purchase cost of new plant and machinery acquired in April, 2017	70,00,000
	Less: Cost of office appliances, i.e., computers (which have been specifically excluded from the meaning of new plant and machinery)	10,00,000
		60,00,000
(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 u/s 54GB		**70,00,000**

Note: Exemption under section 54GB can be availed on long-term capital gains on transfer of a residential house, since all the conditions given below are fulfilled by Mr. Shakti :

(i) The sale proceeds are used for subscription in the equity shares of an eligible company, being a newly incorporated manufacturing company which qualifies to be a small enterprise under the Micro, Small and Medium Enterprises Act, 2006.

(ii) Mr. Shakti holds more than 50% of the share capital in the said company.

(iii) Further, the amount of subscription as share capital has been utilized by the eligible company for purchase of new plant and machinery within a period of one year from the date of subscription.

Question 38

X. Limited has transferred its Unit N to Y. Limited by way of slump sale on November 30, 2016. The summarised Balance Sheet of X. Limited as on that date is given below:

Liabilities	*₹ (in lakhs)*	*Assets*	*₹ (in lakhs)*
Paid up capital	*1,700*	*Fixed Assets :*	
Reserve & surplus	*620*	*Unit L*	*150*
Liabilities:		*Unit M*	*150*
Unit L	*40*	*Unit N*	*550*
Unit M	*110*	*Other Assets:*	
Unit N	*90*	*Unit L*	*520*
		Unit M	*800*
		Unit N	*390*
Total	***2,560***	***Total***	***2,560***

Using the further information given below, compute the capital gain arising from slump sale of Unit N and tax on such capital gain.

(i) Cost inflation index for financial year 2006-07 and financial year 2016-17 are 519 and 1125, respectively.

(ii) Lump sum consideration on transfer of Unit N is ₹ 880 lakhs.

(iii) Fixed assets of Unit N includes land which was purchased at ₹ 60 lakhs in August 2006 and revalued at ₹ 90 lakhs as on March 31, 2016.

(iv) Other fixed assets are reflected at ₹ 460 lakhs (i.e. ₹ 550 lakhs less value of land) which represents written down value of those assets as per books. The written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 410 lakhs.

(v) Unit N was set up by X. Limited in July, 2007.

Answer

Computation of capital gain on slump sale of Unit N under section 50B

Particulars	₹ (in lacs)
Sale consideration for the slump sale of Unit N	880
Less: Net worth of Unit N (Refer Note 1 below)	770
Long term capital gain arising on slump sale	**110**

Computation of tax liability of X Ltd. on slump sale of Unit N

Particulars	₹ (in lacs)
Tax on capital gains@20%	22.00
Add: Surcharge@7%	1.54
	23.54
Add: Education cess@2% and Secondary and higher education cess@1%	0.71
Total tax liability on capital gain arising on slump sale of Unit N	**24.25**

Notes:

1. The net worth of an undertaking transferred by way of slump sale shall be deemed to the cost of acquisition and cost of improvement for the purposes of section 48 and 49 [Section 50B(2)].

Computation of net worth of Unit N

Particulars	₹ (in lacs)
(A) Book value of non-depreciable assets:	
(i) Land (Revaluation is to be ignored for computing net worth)	60
(ii) Other assets	390
(B) Written down value of depreciable assets under section 43(6)	410
Aggregate value of total assets	860
Less: Value of liabilities of Unit N	90
Net worth of Unit N	**770**

2. Since Unit N is held for more than 36 months, the capital gains of ₹ 110 lacs arising on transfer of such unit would be a long term capital gain taxable under section 112. However, indexation benefit is not available in the case of a slump sale.

Question 39

Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31st March, 2017:

(i) Rental income from property at Bangalore - ₹ 3 lakhs, Standard Rent - ₹ 2,50,000, Fair Rent - ₹ 2,80,000.

(ii) Municipal and water tax paid during 2015-16: Current year ₹ 35,000, Arrears - ₹ 1,50,000.

(iii) Interest on loan borrowed towards major repairs to the property: ₹ 1,50,000.

(iv) Arrears of rent of ₹ 30,000 received during the year, which was not charged to tax in earlier years.

Further, the assessee furnished following additional information regarding sale of property at Chennai :

(i) Mr. Singh's father acquired a residential house in April 1992 for ₹ 25,000 and thereafter gifted this property to the assessee, Mr. Singh on 1st March, 1993.

(ii) The property, so gifted, was sold by Mr. Singh on 10th June 2016. The consideration received was ₹ 25,00,000.

(iii) Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was ₹ 3,90,000.

(iv) Out of the sale consideration received:

(a) On 2/1/2017, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being ₹ 8,00,000 and ₹ 7,00,000, respectively.

(b) On 10/l0/2016, ₹ 10 lakhs was invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2017.

Compute Mr. Singh's taxable income for assessment year 2017-18.

Cost inflation index: F.Y. 1992-93 : 223; F.Y. 2016-17 : 1125

Answer

Computation of taxable income of Mr. Singh for A.Y.2017-18

Particulars	₹	₹
Income from house property		
Gross Annual Value [Higher of Expected Rent & Actual Rent]		3,00,000
Expected Rent (lower of Fair Rent and Standard Rent)	2,50,000	
Actual Rent	3,00,000	
Less: Municipal taxes paid by Mr. Singh during the year (including arrears) [₹ 35,000 + ₹1,50,000]		1,85,000
Net Annual Value (NAV)		1,15,000
Less: Deductions under section 24		
(a) 30% of NAV	34,500	
(b) Interest on loan borrowed for major repairs	1,50,000	1,84,500
		(69,500)
Arrears of rent taxable under section 25A	30,000	
Less: Deduction@30%	9,000	21,000
		(48,500)
Capital Gains		
Full value of consideration	30,00,000	
As per section 50C, the full value of consideration would be the higher of -		
Actual Consideration ₹ 25,00,000		
Stamp Duty Value [₹ 3,90,000/13%] ₹ 30,00,000		
Less: **Indexed cost of acquisition** [₹ 25,000 × 1125/223] As per section 49(1), cost of acquisition of the residential house gifted by Mr. Singh's father to Mr. Singh would be the cost for which Mr. Singh's father acquired the asset	1,26,121	
	28,73,879	

Less: **Exemption under section 54 (₹ 8,00,000 + ₹ 7,00,000)** Purchase of residential house within the stipulated time (within one year before or two years after the date of sale) [Where the flats are situated side by side and the builder had effected the necessary modification to make it as one house, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds] *[CIT v. Ananda Basappa (2009) 331 ITR 211 (Kar.)]*	15,00,000	
Exemption under section 54EC Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six month period, exemption under section 54EC would be available even if the allotment of bonds was made after the expiry of the six months *[Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)]*	10,00,000	3,73,879
Total Income		**3,25,379**

Question 40

Mr. Ramesh purchased a plot of land in Chennai in June 2005 for ₹ 50 lakhs. He decided to sell the land to Mr. Mahesh for ₹ 80 lakhs and received an advance of ₹ 2 lakhs in May, 2009. Mr. Mahesh was unable to complete the agreement and hence, the entire advance was forfeited by Mr. Ramesh.

Again Mr. Ramesh entered into an agreement to sell the land to Mr. Rakesh for ₹ 95 lakhs and received advance money of ₹ 2.50 lakhs in August, 2016. But again the transfer did not materialise due to which the advance money was again forfeited.

On 4th January, 2017, the land was finally sold to Mr. Mukesh for ₹ 105 lakhs and the stamp duty value on that date was ₹ 150 lakhs. During financial year 2016-17, Mr. Ramesh earned business income of ₹ 25 lakhs.

He acquired a new residential property for ₹ 130 lakhs by investing entire sale consideration and his business income.

Determine the total income of Mr. Ramesh for the assessment year 2017-18.

Cost inflation index are:

Financial year	***Cost inflation index***
2005-06	*497*

2009-10	*632*
2016-17	*1125*

Answer

Computation of total income of Mr. Ramesh for A.Y.2017-18

Particulars		₹ in lakhs	₹ in lakhs
Business Income			25.00
Capital Gains			
Full value of consideration		150.00	
As per section 50C, the full value of consideration would be the higher of -			
Actual Consideration	₹ 105 lakhs		
Stamp Duty Value	₹ 150 lakhs		
Less: Indexed cost of acquisition (See Note 1)		108.65	
		41.35	
Less: Exemption under section 54F (See Note 2)		35.84	
Long-term capital gain			5.51
Income from other sources (See Note 3)			2.50
Total Income			**33.01**

Notes:

(1) **Computation of indexed cost of acquisition:**

Particulars	₹ in lakhs
Cost of acquisition	50.00
Less: Advance received from Mr. Mahesh in the previous year 2009-10 and forfeited (to be reduced from cost of acquisition as per section 51, since the same was received before 1.4.2014)	2.00
Cost for the purpose of indexation	48.00
Indexed cost of acquisition (₹ 48 lakhs x 1125/497)	108.65

(2) When capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value of ₹ 150 lakhs under section 50C has been adopted as the full value of consideration, the entire amount of ₹ 130 lakhs reinvested in the residential house within the prescribed period should be considered for the purpose of exemption under section 54F, irrespective of the source of funds for such reinvestment *[Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)].*

$$\text{Exemption u/s 54F} = \text{Capital gains} \times \frac{\text{Cost of new residential house}}{\text{Net Sale consideration}}$$

$$= ₹\ 41.35 \text{ lakhs} \times \frac{₹\ 130 \text{ lakhs}}{₹\ 150 \text{ lakhs}} = ₹\ 35.84 \text{ lakhs}$$

(3) Advance of ₹ 2.50 lakhs received by Mr. Ramesh from Mr. Rakesh in August, 2016 which was forfeited due to the transfer not having materialized, is taxable as per section 56(2)(ix) under the head "Income from other sources", since the same was received on or after 1st April, 2014. Hence, such amount would not be reduced to compute the indexed cost of acquisition while determining capital gains on sale of the property.

Question 41

SS(P) Ltd., a domestic Indian company having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to RV(P) Ltd., a domestic Indian company, by way of demerger. The net book value of assets of SS(P) Ltd. before demerger was ₹ 40 crores. The net book value of assets transferred to RV(P) Ltd. was ₹ 10 crores. The demerger was made in January 2017. In, the scheme of demerger, it was fixed that for each equity share of ₹ 10 each (fully paid up) of SS(P) Ltd., two equity shares of ₹ 10 each (fully paid up) were to be issued.

One Mr. N.K. held 25,000 equity shares in SS(P) Ltd. which were acquired in the financial year 2003-04 for ₹ 6,00,000. Mr. N.K. received 50,000 equity shares from RV(P) Ltd. consequent to demerger in January 2017. He sold all the shares of RV(P) Ltd. for ₹ 8,00,000 in March, 2017. In this background you are requested to answer the following:

(i) Does the transaction of demerger attract any income tax liability in the hands of SS(P) Ltd. and RV(P) Ltd.?

(ii) State the conditions in brief, which are to be satisfied under the Act for a demerger.

(iii) Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV(P) Ltd.

(iv) Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV(P) Ltd.

(v) Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd. and/or RV(P) Ltd.?

(vi) Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income-tax Act, 1961 on the sale of shares of RV(P) Ltd.? If so, state in brief.

Note:	**Financial Year**	**Cost inflation index**
	2003-04	*463*
	2016-17	*1125*

Answer

<table>
<tr><td>(i)</td><td>No, the transaction of demerger would not attract any income-tax liability in the hands of SS(P) or RV(P) Ltd.

As per section 47(vib), any transfer in a demerger, of a capital asset, by the demerged company to the resulting company would not be regarded as "transfer" for levy of capital gains tax if the resulting company is an Indian company.

Hence, capital gains tax liability would not be attracted in the hands of SS(P) Ltd., the demerged company, in this case, since RV(P) Ltd. is an Indian company</td></tr>
<tr><td>(ii)</td><td>As per section 2(19AA), demerger should satisfy the following conditions –

(i) All the property of the undertaking and all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, should become the property and liabilities, respectively, of the resulting company by virtue of the demerger;

They should be transferred at the values appearing in its books of account immediately before the demerger.

(ii) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company.

(iii) The shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company.

(iv) The transfer of the undertaking is on a going concern basis.

(v) The demerger is in accordance with the conditions notified Under section 72A(5) by the Central Government in this behalf.</td></tr>
<tr><td>(iii)</td><td>There would be no capital gains liability in the hands of Mr. N.K. on receipt of shares of RV (P) Ltd., since as per section 47(vid), any issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company will not be regarded as "transfer" for levy of capital gains tax, if the issue is made in consideration of demerger of the undertaking.</td></tr>
<tr><td>(iv)</td><td>Yes, capital gains would arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.
<table><tr><td>Sale consideration</td><td>8,00,000</td></tr><tr><td>Less: Indexed cost of acquisition of shares of RV (P) Ltd.</td><td></td></tr></table></td></tr>
</table>

	Cost of acquisition of shares of RV(P) Ltd. as per section 49(2C): $$\text{Cost of acquisition of shares of SS(P) Ltd.} \times \frac{\text{Net book value of assets transferred in a demerger}}{\text{Net worth of the demerged company immediately before demerger}}$$ $$₹\ 6,00,000 \times \frac{10 \text{ crores}}{40 \text{ crores}} = ₹\ 1,50,000$$	
	Indexed cost of acquisition of shares of RV (P) Ltd. [₹ 1,50,000 × 1125/463]	3,64,471
	Long-term capital gain (since period of holding of shares in demerged company is also to be considered)	**4,35,529**
(v)	**No, sale of shares by Mr. N.K. would not affect the tax benefits availed by SS(P) Ltd. or RV (P) Ltd.** One of the conditions to be satisfied is that the shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger. It is presumed that the condition is satisfied in this case. There is no stipulation that they continue to remain shareholders for any period of time thereafter.	
(vi)	Since the resultant capital gain on sale of shares of RV(P) Ltd. is a long-term capital gain (on account of the period of holding of shares in demerged company being considered by virtue of section 2(42A)(g)), Mr. N.K. can avail exemption – (1) under section 54EC by investing the long-term capital gains in bonds of National Highways Authority of India (NHAI) or Rural Electrification Corporation Ltd. (RECL) within a period of 6 months from the date of transfer; or (2) under section 54EE, by investing the long-term capital gain units of specified fund, within a period of 6 months from the date of transfer. (3) under section 54F by investing the entire net consideration in purchase (within one year before and two years after the date of transfer) or construction (within three years after the date of transfer) of one residential house in India. If part of the net consideration is invested, only proportionate exemption would be available.	

Question 42

K and Co. (firm) had sold all its assets and liabilities as a slump sale on 31-03-2017 to SVPC & Co. (firm) for a lump sum consideration of ₹ 600 lakhs.

The statement of affairs of K & Co. as on 31-03-2017 is as below:

Liabilities	*₹ (in lakhs)*	*Assets*	*₹ (in lakhs)*	
Capital	*1,627*	*Fixed Assets*		
Unsecured Loans	*25*	*Plant & Machinery at WDV*	*250*	
Bank Borrowing	*500*	*Land (At Revalued figure)*	*1,200*	*1,450*
Sundry Creditors	*80*	*Current Assets:*		
		Sundry Debtors	*380*	
		Cash & Bank Balances	*2*	
		Loans & Advances	*150*	
		Closing Stock	*250*	*782*
Total	*2,232*	*Total*		*2,232*

Additional Information:

(1) *Cost of land in March 2006 was ₹ 100 lakhs.*

(2) *WDV of Plant & Machinery u/s 43(6) was ₹ 200 lakhs.*

(3) *Cost Inflation Index for the financial year 2005-06 was 497 and for 2016-17 is 1125.*

(4) *Stock is overvalued by 10%*

Compute capital gain arising from slump sale and tax on such gain.

Answer

As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain.

In this case, it is assumed that the undertaking was set up in March 2006, being the period in which land was acquired. Hence, the resultant capital gain on slump sale is a long-term capital gain. However, as per section 50B(2), indexation benefit is not available in case of slump sale.

Computation of Capital Gain arising from slump sale and tax on such gain

Particulars	**₹ in lakhs**
Slump sale consideration	600.00
Less: Cost of acquisition (net worth) **[*See Working Note below*]**	454.27

Long-term capital gain	**145.73**
Income-tax @ 20% (under section 112)	29.146
Add: **Surcharge@12%, since total income exceeds ₹ 1 crore.**	3.498
	32.644
Add: **Education cess@2% and secondary and higher education cess@1%**	0.979
Total tax liability	**33.623**

Working Note: Computation of Net worth of the undertaking

Particulars	₹ in lakhs	
WDV of block of assets (Plant & Machinery) as per section 43(6)]		200.00
Book value of non-depreciable assets		
- Land (Revaluation not to be considered)	100.00	
- Sundry Debtors	380.00	
- Cash & Bank Balance	2.00	
- Loans & Advances	150.00	
- Closing Stock (₹ 250 lakhs – ₹ 22.73 lakhs, being the amount of over-valuation i.e., 10/110 × ₹ 250) **[See Note below]**	227.27	859.27
		1059.27
Less: Liabilities		
- Unsecured Loans	25.00	
- Bank Borrowing	500.00	
- Sundry Creditors	80.00	605.00
Net worth		**454.27**

Note: *Book value of assets (other than depreciable assets) has to be considered for the purpose of arriving at the net worth. Stock has to be valued at lower of cost or net realizable value as per AS 2 and this is the value to be reflected in the Balance Sheet of an entity. For this reason, the effect of over-valuation of stock has been removed while computing the net worth of the undertaking.*

Exercise

1. *Discuss the conditions to be satisfied for claiming exemption of tax in respect of -*

   (a) *Capital gains on compulsory acquisition of agricultural land situated within specified urban limits*

   (b) *Capital gains on sale of listed equity shares/units of an equity oriented fund.*

2. *Write short notes on -*
   (i) *Capital gains in the case of slump sale under section 50B*
   (ii) *Reference to Valuation Officer under section 55A*
3. *Where a holding company receives assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, would the value of assets received by the holding company on the date of distribution be liable to tax?*
4. *The word 'otherwise' used in section 45(4) takes into its fold not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner. Discuss.*
5. *What is the cost of acquisition in a case where the previous owner himself acquired the asset by any of the modes set out in section 49(1)?*
6 *Mr. X had a leasehold property since 5th May, 2009. The leasehold rights were converted into freehold on 20th May, 2016. The said property was sold on 10th January, 2017. The assessee claimed the capital gain as long-term capital gain. The Assessing Officer contended the same as short-term as the property was acquired by converting the leasehold right into freehold right only on 20th May, 2016. Is Mr. X justified in his claim?*

Answers

3. This question was answered by the Gujarat High Court in *CIT v. Brahmi Investments (P.) Ltd. (2006) 286 ITR 66*. In this case, the High Court held that if a holding company had received assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, the value of assets received by the holding company on the date of distribution was liable to tax under section 46(2). Section 47(v), which provides that transfer of a capital asset by a subsidiary company to its 100% holding company (being an Indian company) would not be regarded as a transfer for the purpose of charge of capital gains tax, would not be applicable in this case.

4. The Bombay High Court made a landmark judgment in deciding this issue in *Commissioner of Income-tax v. A.N. Naik Associates (2004) 136 Taxman 107*. The Court applied the "mischief rule" about interpretation of statutes and pointed out that the idea behind the introduction of sub-section (4) in section 45 was to plug in a loophole and block the escape route through the medium of the firm.

The High Court observed that the expression 'otherwise' has not to be read ejusdem generis with the expression 'dissolution of a firm or body of individuals or association of persons'. The expression 'otherwise' has to be read with the words 'transfer of capital assets by way of distribution of capital assets. If so read, it becomes clear that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression 'otherwise' since the object of the amendment was to remove the loophole which existed, whereby capital gains tax was not chargeable. Therefore, the word 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners.

5. The Madras High Court, in *CIT v. Theatre Sri Rangaraja (2004) 135 Taxman 269*, observed that the *Explanation* to section 49(1) makes it clear that where the previous owner of an asset which was sold had himself acquired it by any of the modes set out in section 49(1)(i) to (iv), it is the cost incurred by the owner who had owned the asset prior to the previous owner that is required to be taken into account and not the cost incurred by the previous owner at the time he received the asset in any of the modes set out in sub-clauses (i) to (iv) of section 49(1).

6. The issue under consideration in this case is where a leasehold property is purchased and converted into freehold property at a later point of time and then sold, should the period of holding be reckoned from the date of purchase or from the date of conversion for determining whether the resultant capital gains is short-term or long-term.

The facts of the case are similar to the facts in *CIT v. Smt. Rama Rani Kalia (2013) 358 ITR 0499 (All.).* In that case, it was observed that the conversion of leasehold property into freehold property was nothing but improvement of the title over the property, as the assessee was the owner prior to conversion. Further, the difference between "short-term capital asset" and "long-term capital asset" is the period for which the property has been held by the assessee and not the nature of title over the property.

The lessee of the property has rights as the owner of the property subject to the covenants of the lease deed. Accordingly, the lessee may, subject to covenants of the lease deed, transfer the leasehold rights of the property with the consent of the lessor.

The Allahabad High Court, thus, held that conversion of rights of the lessee from leasehold to freehold is only by way of improvement of his rights over the property, which he enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period for which the property is held, both as leasehold and as freehold.

Therefore, in this case, the period of holding of the property by Mr. X would be reckoned from 5th May 2009 to 10th January 2017, which is more than 36 months. Consequently, the resultant capital gains would be long-term.

Thus, the claim of Mr. X to treat the capital gain as long term capital gain, is justified.

8

Income from Other Sources

Question 1

Dhaval is in business of manufacturing customized kitchen equipments. He is also the Managing Director and held nearly 65% of the paid-up share capital of Aarav (P) Ltd. A substantial part of the business of Dhaval is obtained through Aarav (P) Ltd. For this purpose, Aarav (P) Ltd. passed on the advance received from its customers to Dhaval to execute the job work entrusted to him.

The Assessing Officer held that the advance money received by Dhaval is in the nature of loan given by Aarav (P) Ltd. to him and accordingly is deemed dividend within the meaning of provisions of section 2(22)(e) of the Income-tax Act, 1961. The Assessing Officer, therefore made the addition by treating advance money as the deemed dividend income of Dhaval.

Examine whether the action of the Assessing Officer is tenable in law.

Answer

As per section 2(22)(e), in case a company, not being a company in which the public are substantially interested, makes payment of any sum by way of advance or loan to a shareholder holding not less than 10% of voting power/share capital of the company, then, the payment so made shall be deemed to be dividend in the hands of such shareholder to the extent to which the company possesses accumulated profits.

In the present case, Dhaval is holding 65% of the paid-up capital of Aarav (P) Ltd. Aarav (P) Ltd. has passed on advance received from its customers to Dhaval for execution of job work entrusted to Dhaval.

Since Aarav (P) Ltd. is not a company in which public are substantially interested, the applicability of the provisions of section 2(22)(e) in respect of such transaction has to be examined. In *CIT v. Rajkumar (2009) 318 ITR 462 (Del.),* it was held that trade advance given to the shareholder which is in the nature of money transacted to give effect to a commercial transaction, would not be deemed to be dividend in the hands of the shareholder under section 2(22)(e). The Delhi High Court ruling in *CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376* also supports the above view.

In the present case, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, it shall not be deemed as dividend in the hands of Dhaval under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Question 2

MNO Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 31.3.2016 amounted to ₹ 10,00,000. The company lent ₹ 1,00,000 to K by an account payee bank draft on 1.10.2016. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.3.2017. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2017-18.

Answer

As per section 2(22)(e), any payment by a company, in which the public are not substantially interested, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, shall be treated as dividend to the extent to which the company possesses accumulated profits.

In the instant case, MNO Ltd. is a company in which the public are not substantially interested. The company has accumulated profits of ₹ 10,00,000 on 31.3.2016. The loan given by the company to K was not in the course of its business. K holds more than 10% of the equity shares in the company. Therefore, assuming that K has voting power equivalent to his shareholding, section 2(22)(e) comes into play and the sum of ₹ 1,00,000, representing the amount lent by the company to K, is includible as dividend in the total income of K for the assessment year 2017-18.

Under section 2(22)(e), the liability arises the moment the loan is borrowed by the shareholder and it is immaterial whether the loan is repaid before the end of the accounting year or not. Therefore, the repayment of loan by K to the company on 30.3.2017 will not affect the taxability of the sum of ₹ 1,00,000 as dividend in his hands.

Question 3

Parimal, Managing Director of Heavens Engg. Pvt. Ltd. holds 70% of its paid up capital of ₹ 20 Lacs. The balance as at 31.03.2016 in General Reserve was ₹ 6 Lacs. The company on 1.07.2016 gave an interest-free loan of ₹ 5 Lacs to its Supervisor having salary of ₹ 4,000 p.m., who in turn on 15.8.2016 advanced the said amount of loan so taken from the company to Shri Parimal. The Assessing Officer had taxed the amount of advance in the hands of Parimal. Is the action of Assessing Officer correct?

Answer

The company had advanced a loan to an employee who in turn had advanced the same to the Managing Director of the company holding 70% of its capital. By virtue of the provisions of section 2(22)(e), the same shall be treated as the payment by a company in which public are not substantially interested, on behalf of, or for individual benefit of any such share holder (who holds not less than 10% of the voting power), to the extent to which the company possesses accumulated profits.

In this case, the company has reserves of ₹ 6 Lacs on 31st March of the preceding year and the amount of loan advanced on 1st July is ₹ 5 Lacs. Therefore, the payment is to be treated as deemed dividend. The amount of interest-free loan of ₹ 5 Lacs given by the company to the supervisor who in turn had given the same to Mr. Parimal, shall be construed as the amount given for the benefit of Mr. Parimal and is treated as deemed dividend chargeable to tax in the hands of Mr. Parimal. This has been held by the Supreme Court in the case of *L. Alagusundaram Chettiar v. CIT (2001) 252 ITR 893.*

Question 4

HLI Private Limited is a company with three shareholders H (40%), L (20%) and I on behalf of his HUF (40%). I (HUF) is a Hindu Undivided Family whose members are Mr. I, Mrs. I and their two sons, G and J. The company gave a loan of ₹ 9 lakhs to I (HUF) on 30th April, 2015, on which date the accumulated profits of the company was ₹ 6 lakhs. What is the tax consequence of this transaction?

Answer

The issue under consideration in this case is whether, where the Karta is a shareholder (on behalf of his HUF) of a company in which public are not substantially interested, the loan advanced by the company to the HUF would constitute deemed dividend under section 2(22)(e) to the extent to which the company possesses accumulated profits.

There are two views on the basis of which this question can be answered.

First view

Section 2(22)(e) would be attracted if the loan is given by a company in which public are not substantially interested to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of voting power.

On a plain reading of section 2(22)(e), it appears that the said provision would be attracted only if the person to whom the loan is given is a registered shareholder as well as beneficial owner.

If this view is taken, then section 2(22)(e) would not be attracted in this case, since the registered shareholder is Mr. I (on behalf of his HUF), whereas the beneficial owner is his HUF.

Therefore, loan given to the HUF would not be deemed as dividend by applying section 2(22)(e).

Note – *This view was taken by the Supreme Court in Rameshwarlal Sanwarmal v. CIT (1980) 122 ITR 1 (SC).*

Second view

Section 2(22)(e) would be attracted if the loan is given by a company in which public are not substantially interested to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of voting power.

Even though on a plain reading of section 2(22)(e), it appears that the said provision would be attracted only if the person to whom the loan is given is a registered shareholder as well as beneficial owner, the Delhi High Court, in *CIT v. National Travel Services (2012) 347 ITR 305/(2011) 202 Taxman 327*, has taken a view that where loan is given by a company to a firm, being the beneficial owner of shares held in the name of its partners, provisions of section 2(22)(e) would be attracted, since the essential condition to be satisfied is that of beneficial ownership and it is not necessary that the beneficial owner has to be a registered shareholder.

If this view is adopted, then section 2(22)(e) would get attracted in this case. The loan to the HUF, being the beneficial owner, would be deemed as dividend in the hands of the HUF.

It would, however, be taxable only to the extent to which the company possesses accumulated profits on the date of loan i.e., in this case, ₹ 6 lakh.

Question 5

Mr. Santhanam holding 25% voting power in VKS Manufacturing Private Limited permitted his own land to be mortgaged to a bank for enabling the company to obtain a loan. Mr. Santhanam requested the company to release the property from the mortgage. The company failed to do so, but for retaining the benefit of bank loan it gave an advance of ₹ 10 lakhs to Mr. Santhanam, which was authorized by a resolution passed by the Board of Directors. The company's accumulated profit on the date of payment of advance was ₹ 50 lakhs. The Assessing Officer proposes to tax the amount of ₹ 10 lakhs by invoking the provision of section 2(22)(e).

Is the proposition of the Assessing Officer correct in law?

Answer

The issue under consideration is whether loan or advance given to a shareholder by the company, in return of an advantage or benefit conferred on the company by the shareholder, can be deemed as dividend under section 2(22)(e) of the Income-tax Act, 1961 in the hands of the shareholder

The facts of the case are similar to the facts in *Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538*, wherein the above issue came up before the Calcutta High Court.

The High Court observed that the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power.

In case such loan or advance is given to such shareholder as a consequence of any further consideration received from such a shareholder which is beneficial to the company, such advance or loan cannot be a deemed dividend within the meaning of the Act.

Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) to the extent of accumulated profits of the company but not the cases where the loan or advance is given in return for an advantage conferred upon the company by such shareholder.

In this case, advance of ₹ 10 lakhs was given by VKS Manufacturing (P) Ltd. to Mr. Santhanam holding 25% of voting power in lieu of non-release of his personal property from mortgage thereby enabling the company to retain the benefit of loan obtained from bank. Therefore, applying the rationale of the Calcutta High Court ruling in *Pradip Kumar Malhotra's* case, such advance cannot be brought within the purview of section 2(22)(e), since it was not in the nature of gratuitous advance but was given to protect the interest of the company.

The proposition of the Assessing Officer to tax the amount of ₹ 10 lakhs by invoking the provisions of section 2(22)(e) in this case is, therefore, **not correct**.

Question 6

V.G. had placed a deposit of ₹ 10 lacs in a bank on which he received interest of ₹ 80,000. He had also borrowed ₹ 5 lacs from the same bank on the security of the deposit and was liable to pay ₹ 50,000 by way of interest to the bank. He, therefore, offered the difference between two amounts of ₹ 30,000 as income from other sources. Is this correct?

Answer

The interest income from deposit in the bank is assessable under the head "Income from Other Sources". The deduction admissible against this income is any expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income. However, the interest paid on the borrowing of ₹ 5 Lacs does not fall in this category. This has been held by the Supreme Court in *CIT v. Dr. V. Gopinathan (2001) 248 ITR 449.* In that case, the Supreme Court observed that the interest received by the assessee from the bank on a fixed deposit is income in his hands and there could be no deduction there from unless there is a law permitting such deduction. The interest on a loan taken by the assessee on the security of the fixed deposit would not go to reduce the income by way of interest on the fixed deposit as there is no provision for deduction of such interest on the loan.

Therefore, in this case, the full sum of ₹ 80,000 will be liable to tax under the head "Income from Other Sources".

Note: *In case the assessee had deposited business funds and availed loan against such deposit for business use of such loan, the interest on loan against deposit is eligible for deduction.*

Question 7

Shyam was contributing amount to unrecognized provident fund. On 15th March, 2017, he had finally drawn the deposited amount along with interest. He seeks your advice as to how it has to be dealt, in his computation for assessment year 2017-18.

Answer

Shyam's own contribution to the unrecognized provident fund will not attract any tax liability at the time of withdrawal. However, the payment received from an employer or former employer to the extent of employer's contribution and interest therein is taxable as profit in lieu of salary under section 17(3)(ii).

Further, interest on own contribution to unrecognized provident fund, is taxable under the head "Income from other sources".

Question 8

M, an individual, is 70 years of age. He is a sitting member of the State Assembly of Karnataka and for the financial year 2016-17 received the following amounts from the Assembly Secretariat:

(i)	*Basic pay*	*₹ 16,000 p.m.*
(ii)	*Constituency allowance*	*₹ 8,000 p.m.*
(iii)	*Telephone allowance*	*₹ 4,000 p.m.*
(iv)	*Electricity allowance*	*₹ 3,000 p.m. [from June, 2016 onwards]*

He owns a house in Delhi which has been let out at ₹ 15,000 p.m. He received rent for 10 months only, the house having remained vacant for two months. Municipal taxes of ₹ 12,000 were paid by the tenant. Interest of ₹ 50,000 was paid by M on the amount borrowed by him to buy the house.

Compute his total income for the assessment year 2017-18.

Answer

Computation of total income of Mr. M for A.Y.2017-18

Particulars		₹	₹
Income from house property			
Gross Annual Value (GAV) **[See Note 1 below]**		1,50,000	
Municipal taxes (not allowed since it is borne by tenant)		-	
Net annual value (NAV)		1,50,000	
***Less*: Deduction under section 24**			
(a) 30% of NAV	₹ 45,000		

(b) Interest on borrowed capital	₹ 50,000	95,000	55,000
Income from Other Sources [See Note 2 below]			
Basic Pay (₹ 16,000 x 12)		1,92,000	
Constituency allowance (₹ 8,000 x 12)	₹ 96,000		
Less: Exempt under section 10(17)	₹ 96,000	-	
Electricity allowance (₹ 3,000 x 10)		30,000	
Telephone allowance (₹ 4,000 x 12)		48,000	2,70,000
Total Income			**3,25,000**

Notes:

(1) In the absence of other information, rent received has been taken as the Gross Annual Value.

(2) The pay and allowances of a member of the State Assembly would be taxable under the head "Income from other sources", since there is no employer-employee relationship in this case.

Question 9

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 1.4.2016 on a consolidated lease rent of ₹ 50,000 per month. Compute the income for Assessment Year 2017-18 of the assessee from following information:

		₹
(i)	*Interest received on deposits*	*1,00,000*
(ii)	*Brokerage paid on hundi loan taken*	*2,000*
(iii)	*Interest paid on hundi and other loans which were given as deposits on interest to others*	*75,000*
(iv)	*Expenses incurred on repairs of building, plant and machinery*	*15,000*
(v)	*Fire insurance premium of plant and machinery and furniture*	*12,000*
(vi)	*Depreciation for the year*	*1,47,500*
(vii)	*Legal fees paid to an advocate for drafting and registering the lease agreement*	*1,500*
(viii)	*Factory licence fees paid for the year*	*1,000*

(ix) There is unabsorbed depreciation of ₹ 2,75,000 of the Assessment Years 2015-16 and 2016-17.

(x) *Interest paid includes an amount of ₹ 25,000 remitted to a non-resident outside India on which tax was not deducted at source.*

Answer

The income derived from leased assets shall be chargeable to tax as 'Income from other sources' under section 56(2)(iii) but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38. This is as per the provisions of section 57(ii) and 57(iii).

Computation of income under the head "Income from other sources"

Particulars		₹	₹
(A) Lease Rent for 12 months @ ₹ 50,000 p.m.			6,00,000
Less: Expenses and deductions allowable under section 57(ii) & 57(iii):			
Repairs		15,000	
Fire Insurance Premium		12,000	
Legal expenses for drafting of lease agreement		1,500	
Factory Licence fee		1,000	
Depreciation for the year		1,47,500	
Unabsorbed depreciation of earlier assessment years – eligible for deduction **(Note 1)**		2,75,000	4,52,000
			1,48,000
(B) Interest on Deposits		1,00,000	
Less: Expenses allowable under section 57(i)			
Brokerage	₹ 2,000		
Interest on hundi loans **(Note 2)**	₹ 50,000	52,000	48,000
Total Income			**1,96,000**

Note:

1. Unabsorbed depreciation of ₹ 2,75,000 pertains to earlier assessment years. The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of ₹ 2,75,000 is adjustable / allowed to be set off against 'Income from other sources'.
2. Since deposits are made by investing amount received on hundi and other loans, the interest on hundi and other loans would be eligible for deduction from the income arising on such deposits.
3. Interest paid to non-resident is not eligible for deduction as the tax has not been deducted at source.

Question 10

In July 2016, Mr. Pervez employed as Marketing Manager in a Pharma company, received a Maruti car as gift from a distributor of the company. The value of the gifted car is estimated at ₹ 2,60,000. Is the value of car taxable as income? If so, under what head it is taxable?

Answer

Mr. Pervez, an employee of a Pharma company, has received a car as a gift from a distributor of the company. Since there is no employer-employee relationship in this case between the distributor and Mr. Pervez, the value of gift is **not** a perquisite chargeable to tax under the head "Salaries".

Section 56(2)(vii), brings within its scope the value of any property received by an individual or Hindu Undivided Family without consideration. For this purpose, "property" means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.

Therefore, for the purpose of attracting the provisions of section 56(2)(vii) for chargeability under the head "Income from Other Sources", an individual should be in receipt of property as defined therein. Since, car is not included in the definition of "property", the provisions of section 56(2)(vii) would not be attracted in the hands of Mr. Pervez.

Question 11

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961 for the A.Y. 2017-18:

Radhe received on 11.9.2016 gifts each of ₹ 21,000 from his two friends Shiva and Krishna and of ₹ 51,000 from his sister living in UK.

Answer

Section 56(2)(vii) provides that where any sum of money is received without consideration by an individual or a Hindu undivided family from any person or persons and the aggregate value of all such sums received during the previous year exceeds ₹ 50,000, the whole of the aggregate value of such sum shall be included in the total income of such individual or Hindu undivided family under the head "Income from other sources". However, any sum received from a relative would be exempted from the taxability provisions under section 56(2)(vii). Sister of an individual is a relative for the purpose of section 56(2)(vii). Therefore, the gift received by Radhe from sister living in UK would be exempted from the applicability of section 56(2)(vii). Further, gifts received by Radhe on 11.9.2016 from his two friends of ₹ 21,000 each shall not be included in the total income of Radhe since, the aggregate value of all such sums received during the previous year does not exceed ₹ 50,000.

Question 12

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2017 in the following case shall be subject to tax in the A.Y. 2017-18*:*

Chitra received gifts of ₹ 1,00,000 from her father-in-law and of ₹ 11,000 each from her 10 friends at the time of her marriage on 11.03.2017.

Answer

The cash gifts received by Chitra at the time of her marriage shall not be subject to tax by virtue of clause (b) of the second proviso to section 56(2)(vii). Therefore, gifts of ₹ 1 Lac received from her father-in-law and ₹ 1.10 Lacs received @ ₹ 11,000 each from her 10 friends shall not be taxable as all such gifts were received by her on the occasion of her marriage.

Question 13

Discuss the taxability of the following receipts in the hands of Mr. H under the Income-tax Act, 1961 -

(i) Gets ₹ 1,75,000 in cash as a marriage gift from his grandfather on 13.02.2017.

(ii) Received 100 shares of B Ltd., the fair market value of which was ₹ 1,00,000 on his birthday, 21.04.2016 from his friend Mr. J.

(iii) Received ₹ 51,000 from his sister living in UK on 21.09.2016.

(iv) Wrist Watch valued at ₹ 60,000 from his friend on 01.12.2016.

Answer

Where any sum of money is received without consideration by an individual or HUF and the aggregate value of all such sums received during the previous year exceeds ₹ 50,000, the whole of the aggregate value would be included in the total income of the individual under section 56(2)(vii).

(i) Cash of ₹ 1,75,000 received from grandfather as marriage gift: Any sum received from a relative is exempt from the applicability of section 56(2)(vii).

Relative includes ascendant or descendant of the individual. Since grandfather is a lineal ascendant, the amount of ₹ 1,75,000 received from him is not chargeable to tax.

In any case, any sum of money received on the occasion of marriage of the individual is exempt, whether or not received from a relative. So, the amount of ₹ 1,75,000 received from his grandfather is not chargeable to tax.

(ii) Shares received from a friend on 21.04.2016: As per *Explanation* to section 56(2)(vii), property includes shares and securities. Value of shares of B Ltd. gifted by his friend Mr. J on 21.04.2016 is taxable since receipt of property without consideration is chargeable to tax under section 56(2)(vii) if its aggregate fair market value exceeds ₹ 50,000. Since shares are included in the definition of "property" under section 56(2)(vii) and the aggregate fair market value, in this case, exceeds ₹ 50,000, it is taxable under section 56(2)(vii).

(iii) Sum of ₹ 51,000 received from sister: Any sum received from a relative is exempt from the applicability of section 56(2)(vii). Since, sister is a "relative" for the purpose of this clause, the amount of ₹ 51,000 received from her would be exempt.

(iv) Wrist Watch valued at ₹ 60,000 received from a friend on 1.12.2016: Receipt of property without consideration would attract the provisions of section 56(2)(vii). However, the provisions of section 56(2)(vii) are attracted only in respect of "property" as defined in that section. Since wrist watch is not included in the said definition of "property", the receipt of the same without consideration would not attract the provisions of section 56(2)(vii) and the same shall not be taxable in the hands of Mr. H.

Question 14

Mrs. Harini Rao, who draws a salary of ₹ 12,000 p.m. received the following gifts during the previous year 2016-17:

(i) Gift of ₹ 1,50,000 on 15.5.2016 from her close friend.

(ii) Gift of jewellery worth ₹ 3,00,000 on 1.8.2016 from her fiancée.

(iii) Gifts of ₹ 51,000 each received from her two friends on the occasion of her marriage on 30.10.2016.

(iv) Gift of ₹ 51,000 on 1.12.2016 from her father's sister.

(v) Gift of ₹ 21,000 from her husband's friend on 1.1.2017.

(vi) Gift of ₹ 25,000 on 12.1.2017 from her family friend.

(vii) Gift of ₹ 11,000 on 12.2.2017 from her brother's mother-in-law.

(viii) Gift of ₹ 75,000 from her sister-in-law.

Compute her gross total income for the assessment year 2017-18.

Answer

Computation of gross total income of Mrs. Harini Rao for the A.Y. 2017-18

Particulars	₹	₹
Salary		
Salary ₹ 12,000 x 12		1,44,000
Income from other sources		
(i) Cash Gift from close friend is taxable	1,50,000	
(ii) Gift of jewellery is taxable ["Jewellery" is included in the definition of property as per *Explanation* to section 56(2)(vii) and the fair market value exceeds ₹ 50,000]	3,00,000	

(iii)	Gifts received from her two friends are exempt as they have been received on the occasion of her marriage	-	
(iv)	Gift from her father's sister is exempt as the donor is covered in the definition of 'relative'	-	
(vi)	Gift from her husband's friend is taxable	21,000	
(vii)	Gift from her family friend is taxable	25,000	
(viii)	Gift from her brother's mother-in-law is taxable as the donor is not covered in the definition of 'relative'	11,000	
(ix)	Gift from her sister-in-law (husband's sister) is exempt as the donor is covered in the definition of 'relative'	-	
			5,07,000
Gross Total Income			**6,51,000**

Question 15

Discuss the taxability or otherwise of the following gifts received by M, an individual, during the financial year 2016-17:

(i) *₹ 24,000 each from his four friends on the occasion of his birthday.*

(ii) *Wrist watch valued at ₹ 60,000 from his friend.*

(iii) *Acquired a vacant site from a friend (non-relative). The stamp duty value of the land was ₹ 5 Lacs but the consideration paid and agreed was ₹ 3 Lacs.*

(iv) *Received a gift of vacant land from grandfather's younger brother, the stamp duty value of the land being ₹ 1,50,000.*

Answer

(i) Section 56(2)(vii) provides that where any sum of money is received without consideration by an individual or a Hindu undivided family from any person or persons exceeding ₹ 50,000 in aggregate in any previous year, the whole of the aggregate value of such sum will be liable to tax. In the instant case, M has received ₹ 24,000 from each of his four friends. The aggregate amount of gifts received works out to ₹ 96,000. The entire amount of ₹ 96,000 is taxable under the head "Income from other sources".

(ii) Section 56(2)(vii) brings within its scope, in addition to any sum of money, the value of property received without consideration. For this purpose, "property" means immovable property being land and building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bulliion. Therefore, the gift of wrist watch valued at ₹ 60,000 received by M from his friend is not covered by the term 'property'. Accordingly, it is not chargeable to tax.

(iii) As per sub-clause (b) of section 56(2)(vii), where any immovable property is obtained for inadequate consideration and if the difference between stamp duty value of the property and the consideration exceeds ₹ 50,000, then such difference is chargeable to tax as income. In this case, the difference is ₹ 2,00,000 (i.e. ₹ 5,00000 - ₹ 2,00,000). Therefore, the same is chargeable to tax in the hands of Mr. M.

(iv) Since the younger brother of grandfather is not a 'relative' as per *Explanation* to section 56(2)(vii), the stamp duty value of land received without consideration from him is chargeable to tax as income under the head 'Income from other sources'.

Question 16

D, a lady, received *the following gifts during the year ending 31.3.2017:*

(i) ₹ 30,000 from her elder sister.

(ii) ₹ 1,25,000 from various friends on the occasion of her marriage.

(iii) ₹ 50,000 from the daughter of her elder sister.

Discuss the taxability or otherwise of these gifts in the hands of D.

Answer

(i) Section 56(2)(vii) provides for taxation of gifts exceeding ₹ 50,000, received by an individual from any person other than those specified, under the head "Income from other sources". The proviso states that gifts received from any relative would not be so taxed. *Explanation* to section 56(2)(vii) defines the term "relative". Sister of the individual is included in the said definition. Therefore, gift of ₹ 30,000 received by D from her elder sister is not taxable.

(ii) The proviso to section 56(2)(vii) stipulates that gifts received by an individual on the occasion of the marriage of the individual, is not taxable. Therefore, gifts amounting to ₹ 1,25,000 received by D from her friends on the occasion of her marriage are not taxable.

(iii) Daughter of the elder sister of an individual is not a "relative" within the definition of the term as contained in *Explanation* to section 56(2)(vii). Since the amount received from the daughter of her elder sister is exactly ₹ 50,000 and the gifts received in (i) and (ii) above are not chargeable, the whole of the amount gifted shall not be included in D's total income. Therefore, the entire sum of ₹ 50,000 is not taxable in the hands of D.

Question 17

Mr. Ganesh received the following gifts during the P.Y. 2016-17 from his friend Mr. Sundar, -

(1) Cash gift of ₹ 51,000 on his birthday, 19th June, 2016.

(2) 50 shares of Beta Ltd., the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2016.

(3) 100 shares of Alpha Ltd., the fair market value of which was ₹ 70,000 on the date of transfer. This gift was received on the occasion of Diwali. Mr. Sundar had originally purchased the shares on 10.8.2016 at a cost of ₹ 50,000.

Further, on 20th November, 2016, Mr. Ganesh purchased land from his sister's mother-in-law for ₹ 5,00,000. The stamp value of land was ₹ 7,00,000.

On 15th February, 2017, he sold the 100 shares of Alpha Ltd. for ₹ 1 Lac.

Compute the income of Mr. Ganesh chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2017-18.

Answer

Computation of "Income from other sources" of Mr. Ganesh for the A.Y.2017-18

	Particulars	₹
(1)	Cash gift received on 19.06.2016 is taxable under section 56(2)(vii)	51,000
(2)	Value of shares of Beta Ltd. gifted by Mr. Sundar on 19th June, 2016 is taxable as "shares" are included within the definition of "property"	60,000
(3)	Fair market value of shares of Alpha Ltd. is taxable	70,000
(4)	Purchase of land for inadequate consideration on 20.11.2016 would attract the provisions of section 56(2)(vii), if the difference between stamp duty value and actual consideration exceeds ₹ 50,000. Since the difference between Stamp Duty Value and Consideration is ₹ 2,00,000 (i.e., ₹ 7,00,000 - ₹ 5,00,000), **it is chargeable to tax.** Sister's Mother-in-law is not a relative within the meaning of section 56(2)(vii).	2,00,000
Income from Other Sources		**3,81,000**

Computation of "Capital Gains" of Mr. Ganesh for the A.Y.2017-18

Particulars	₹
Sale Consideration (15.02.2017)	1,00,000
Less: Cost of acquisition [deemed to be the fair market value charged to tax under section 56(2)(vii)] [as per section 49(4)]	70,000
Short-term capital gains	**30,000**

Question 18

Discuss the liability of the following receipts, during the year ended 31st March, 2017, in the hands of Ms. Jyoti under the Income-tax Act, 1961:

(i) Gift of ₹ 60,000 in cash from her father's sister on her birthday.

(ii) Acquired a vacant site from grandfather's younger brother. The stamp duty value of the land was ₹ 3 lakhs but the consideration paid was ₹ 2 lakhs.

(iii) Received a car from her friend on payment of ₹ 2,50,000, the market value of which was ₹ 3,00,000.

(iv) Interest on enhanced compensation on the order of court, from NHAI in respect of her land which was compulsorily acquired, was received ₹ 3,50,000 on 12-11-2016 which includes interest of ₹ 2,00,000 pertaining to previous year 2014-15.

(v) Received cash gift of ₹ 15,000 each from three of her friends.

Answer

(i) Gift of ₹ 60,000 in cash received on her birthday would not be taxable in the hands of Ms. Jyoti, since such sum is received from father's sister who is a relative [as per clause (e) of *Explanation* to section 56(2)(vii)].

(ii) As per section 56(2)(vii)(b), where any immovable property is obtained for inadequate consideration from a person (other than relative) and the difference between stamp duty value of the property and the consideration exceeds ₹ 50,000, then such difference is chargeable to tax as income under the head "Income from Other Sources".

In the present case, since the younger brother of grandfather is not a 'relative' [as per clause (e) of *Explanation* to section 56(2)(vii)], and the difference between the stamp duty of land and consideration paid i.e., ₹ 1,00,000 (₹ 3,00,000 – ₹ 2,00,000) exceeds ₹ 50,000, the difference of ₹ 1,00,000 would be chargeable to tax in the hands of Ms. Jyoti under section 56(2)(vii) under the head "Income from Other Sources".

(iii) Since car is not included in the definition of property [as per clause (d) of *Explanation* to section 56(2)(vii)], the difference between fair market value and purchase price of car is not taxable in the hands of Ms. Jyoti under section 56(2)(vii)(c).

In any case, the difference between the fair market value and purchase price does not exceed ₹ 50,000.

(iv) As per section 145A(b), interest received during the year on enhanced compensation shall be deemed to be the income of the year in which such interest is received, irrespective of the method of accounting followed by the assessee.

Hence, the interest of ₹ 3,50,000 (including interest of ₹ 2,00,000 pertaining to previous year 2014-15) received by Ms. Jyoti, is taxable under section 56(2)(viii) in the previous year 2016-17 after allowing deduction @50% under section 57(iv).

Accordingly, ₹ 1,75,000 (₹ 3,50,000 – ₹ 1,75,000), being 50% of ₹ 3,50,000) would be taxable in her hands under the head "Income from Other Sources".

(v) Cash gifts of ₹ 45,000 (₹ 15,000 x 3) received from three of her friends is not taxable under section 56(2)(vii) in the hands of Ms. Jyoti, since its aggregate value does not exceed ₹ 50,000.

Question 19

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*
Win (P) Ltd.	*370*	*300*	*350*	*1,00,000*
Gain (P) Ltd.	*330*	*300*	*350*	*2,00,000*
Profit (P) Ltd.	*290*	*300*	*280*	*3,00,000*
Top (P) Ltd.	*310*	*300*	*275*	*4,00,000*

Answer

Applicability of the provisions of section 56(2)(viib)

Co.	Face value of shares (₹)	FMV of shares (₹)	Consideration received (₹)	Applicability of section 56(2)(viib)
Win (P) Ltd.	300	350	370	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., ₹ 20 lakh, being ₹ 20 (₹ 370 - ₹ 350) per share × 1,00,000 shares, shall be treated as income in the hands of Win (P) Ltd.
Gain (P) Ltd.	300	350	330	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 Gain (P) Ltd. as the shares are issued at a price less than the FMV of shares.
Profit (P) Ltd.	300	280	290	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.
Top (P) Ltd.	300	275	310	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium. The excess of

				the issue price of the shares over the FMV would be taxable under section 56(2)(viib). Therefore, ₹ 140 lakh, being ₹ 35 (₹ 310 - ₹ 275) per share × 4,00,000 shares, shall be treated as income in the hands of Top (P) Ltd.

Question 20

Mr. X received the following gifts / amounts during the previous year 2016-17:

(i) Gift of bullion worth ₹ 60,000 on his birthday from his friend.

(ii) Received a car from his cousin on payment of ₹ 1 lac, fair market value of which was ₹ 4 lacs.

(iii) Received cash gift of ₹ 18,000 each from three of his friends A, B & C on 24-09-2016.

(iv) Acquired an office building on 22-11-2016 from his friend Q for a consideration of ₹ 10 lacs, stamp value of which is ₹ 20 lacs.

(v) In respect of land of Mr. X acquired by Railways in the year 2014, he received the following amount on 25-12-2016 as interest on enhanced compensation on the order of the court –

Relating to previous	₹
2014-15	1.45.000
2015-16	1,75,000
2016-17	1,10,000

You are required to compute the income of Mr. X chargeable under the head "Income from other sources" for the Assessment Year 2017-18, assuming that he has no other income.

Answer

Computation of "Income from other sources" of Mr. X for the A.Y.2017-18

	Particulars	₹
(i)	Since bullion is included in the definition of "property", therefore, when bullion is received without consideration, the same is taxable under section 56(2)(vii), as the aggregate fair market value of bullion exceeds ₹ 50,000	60,000
(ii)	Since car is not included in the definition of property, therefore the difference of ₹ 3 lakh between fair market value and purchase price of car is **not** taxable under section 56(2)(vii)	Nil
(iii)	Cash gift received from friends is taxable under section 56(2)(vii), since its aggregate value exceeds ₹ 50,000 (₹ 18,000 × 3)	54,000
(iv)	Immovable property purchased for inadequate consideration is taxable	

	under section 56(2)(vii). Therefore, the difference of ₹ 10 lakh between stamp duty value and purchase price of building **is taxable** u/s 56(2)(vii).	10,00,000
(v)	As per section 145A, interest received during the year on enhanced compensation shall be deemed to be the income of the year in which such interest is received, irrespective of the method of accounting followed by the assessee. Hence, the interest received by Mr. X, is taxable u/s 56(2)(viii) in the previous year 2016-17. (₹ 1,45,000 + ₹ 1,75,000 + ₹ 1,10,000) ₹ 4,30,000 *Less:* Deduction under section 57 @50% of ₹ 4,30,000 ₹ 2,15,000	2,15,000
Income from Other Sources		**13,29,000**

Question 21

From the following particulars, compute the gross total income of Mr. Z for the assessment year 2017-18:

(i) Mr. Y transferred his residential house to Mr. Z for ₹ 10 lakh on 1.4.2016. The value of the said house as per stamp valuation authority was ₹ 18 lakhs. Mr. Z is a childhood friend of Mr. Y.

(ii) Mr. Z received a car from his cousin on payment of ₹ 2,50,000, fair market value of which was ₹ 4,00,000.

(iii) Land of Mr. Z was acquired by railways in 2013. On 15/12/2016, he received ₹ 1,70,000 as interest on enhanced compensation on the order of court.

(iv) On a fixed deposit of ₹ 10 lakhs, in a bank, Mr. Z received an interest of ₹ 90,000. He had also borrowed ₹ 50 lakhs from the same bank, on security of the fixed deposit and was liable to pay ₹ 50,000 by way of interest to the bank. He, therefore, offered the difference between the two amounts i.e. ₹ 40,000 as "Income from Other Sources".

Answer

Computation of gross total income of Mr. Z for the A.Y.2017-18

	Particulars	**₹**
Income from Other Sources		
(i)	Receipt of immovable property for inadequate consideration attracts the provisions of section 56(2)(vii). The difference between the stamp duty value (₹ 18 lakhs) and the actual consideration (₹ 10 lakhs) would be taxable.	8,00,000
(ii)	Since car is not included in the definition of "property" under section 56(2)(vii), receipt of car for inadequate consideration would not attract the provisions of section 56(2)(vii).	-
(iii)	Interest on enhanced compensation amounting to ₹ 1,70,000 would be taxable under section 56(2)(viii) in the year of receipt.	85,000

	Deduction@50% is allowable under section 57(iv). Hence, the taxable interest is ₹ 85,000 (i.e., ₹ 1,70,000 – ₹ 85,000)	
(iv)	Interest of ₹ 90,000 received on fixed deposit is income of Mr. Z. The interest of ₹ 50,000 on loan taken by Mr. Z from the same bank on security of the fixed deposit will not go to reduce the income by way of interest on fixed deposit *[CIT v. D. V. Gopinathan (2001) 248 ITR 449].*	90,000
Gross Total Income		**9,75,000**

Question 22

Mr. X transferred his residential house to Y for ₹ 10 lakh on 1st April, 2016. The value of the said house as per Stamp Valuation Authority was ₹ 16 lakh. Mr. Y is a childhood friend of Mr. X.

Mr. X gifted a plot of land (purchased by him on 1st August, 2010) to Mr. Y on 1st July, 2016. The value as per Stamp Valuation Authority is ₹ 8 lakh. Mr. Y sold the land on 1st March, 2017 at ₹ 15 lakh. Compute the income of Mr. Y chargeable under the heads "Capital Gains" and "Income from other sources" for Assessment Year 2017-18.

Cost Inflation Index - 2010-11: 711; 2016-17: 1125.

Answer

Computation of income of Mr. Y chargeable under the heads "Capital Gains" and "Income from other sources" for A.Y. 2017-18

Particulars	₹
Income chargeable under the head "Capital Gains"	
Sale consideration	15,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(vii) as per section 49(4) **(See Note 3]**	8,00,000
Short-term capital gains **(See Note 4)**	**7,00,000**
Income from other sources	
Difference between stamp duty value of residential house and actual consideration paid [Residential house received for inadequate consideration]	6,00,000
Stamp duty value of plot of land received without consideration (taxable under section 56(2)(vii) (**See Note 2)**	8,00,000
	14,00,000

Notes:

(1) Transfer of immovable property for inadequate consideration attracts the provisions of section 56(2)(vii), if the difference between the stamp duty value and actual consideration exceeds ₹ 50,000. Therefore, the provisions of section 56(2)(vii) are attracted in respect of transfer of residential house by Mr. X to Mr. Y for inadequate consideration. The

difference of ₹ 6 lacs between stamp duty value and actual consideration is taxable under section 56(2)(vii).

(2) The provisions of section 56(2)(vii) are also attracted in respect of transfer of immovable property without consideration, if the stamp duty value of such property exceeds ₹ 50,000. In this case, since Mr. Y has received a plot of land from Mr. X, a non-relative, without consideration and the stamp duty value of ₹ 8 lakh exceeds ₹ 50,000, the entire stamp duty value of ₹ 8 lakh is chargeable to tax under section 56(2)(vii).

(3) Section 49(4) provides that where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(vii), the cost of acquisition shall be deemed to be the value taken into account for the purpose of section 56(2)(vii). Therefore, ₹ 8 lakh would be the cost of acquisition of land in this case.

(4) The resultant capital gains will be short-term capital gains since for calculating the period of holding, in a case where cost is computed under section 49(4), the period of holding of the previous owner is not to be included. As per section 2(42A), the period of holding will include the period of holding of the previous owner only in the case of a capital asset which becomes the property of the assessee in the circumstances mentioned in section 49(1) [i.e., where cost to previous owner would be deemed as the cost of acquisition].

Question 23

Discuss the taxability or otherwise of the following transactions under section 56(2) of the Income-tax Act, 1961:

(i) Bharat is the Karta of Bharat HUF. Sujata, daughter of Bharat is a member of the HUF. She transferred a house property to the HUF without any consideration. The value of the house property for stamp duty purpose is ₹ 10 lakhs.

(ii) JD Private Limited issued 50,000 equity shares of face value of ₹ 10 per share at a premium of ₹ 60 per share. The fair market value of the share as per prescribed rule is ₹ 50 per share.

Answer

(i) Immovable property, being land or building or both, received without consideration by a HUF from its relative is not taxable under section 56(2)(vii).

Since Sujata is a member of Bharat HUF, she is a "relative" of the HUF. Therefore, if Bharat HUF receives a house property from its member, Sujata, without consideration, the stamp duty value of such property will **not** be chargeable to tax in the hands of the HUF, since such receipt from a "relative" is excluded from the scope of section 56(2)(vii).

(ii) The provisions of section 56(2)(viib) are attracted in this case since the shares of a closely held company are issued at a premium (i.e., the issue price of ₹ 70 per share exceeds the face value of ₹ 10 per share).

The consideration received by the company in excess of the fair market value of the shares would be taxable under section 56(2)(viib).

Therefore, ₹ 10,00,000 {i.e., (₹ 70 – ₹ 50) x 50,000 shares} shall be the income chargeable under the head "Income from other sources" in the hands of JD Private Limited.

Question 24

The land owned by Ganesh was acquired by NHAI in the year 2013 and since then the litigation was going on for enhancement of compensation. The issue was resolved on 11.09.2016 and the court ordered finally to make payment to Ganesh of the enhanced compensation and the following amounts for interest on such enhanced compensation:

Financial Year	*Amount (₹)*
2013-2014	*1,15,000*
2014-2015	*2,25,500*
2015-2016	*3,75,000*
2016-2017	*2,14,500*

Explain the provisions of the Act and also work out the amount of interest and the assessment year in which the same shall be taxed.

Answer

Clause (b) of section 145A provides that the interest received by an assessee on compensation or on enhanced compensation 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.

Clause (viii) inserted in section 56(2) provides that income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be assessed as "Income from other sources" in the year in which it is received.

Clause (iv) inserted in section 57 allows a deduction of 50% of such income. It is further clarified that no other deduction would be allowable under any other clause of section 57 in respect of such income.

Therefore, the entire interest income of ₹ 9,30,000 received by Ganesh for the different years would be taxable under the head "Income from other sources" in the year of receipt i.e., P.Y.2016-17 (A.Y. 2017-18) :-

Particulars	₹
Interest on enhanced compensation taxable under section 56(2)(viii)	9,30,000
Less: Deduction under section 57(iv) @ 50%	4,65,000
Interest chargeable under the head "Income from other sources"	**4,65,000**

Exercise

1. *Write short notes on -*
   a) *Bond washing transactions*
   b) *Dividend stripping*
2. *State the incomes which are chargeable only under the head "Income from other sources".*
3. *Which are incomes chargeable under the head "Income from other sources" only if they are not chargeable under the head "Profits and gains of business or profession"?*
4. *What are the deductions allowable from the following income -*
   a) *Dividend*
   b) *Income from letting on hire machinery, plant or furniture.*
5. *What are the inadmissible deductions while computing income under the head "Income from other sources".*
6. *Is family pension taxable under the head "Salaries" or "Income from other sources"? Is any deduction allowable from such income? Discuss.*
7. *Explain whether the method of accounting followed by an assessee is relevant in computing his income under the head "Income from other sources".*
8. *Explain the meaning and tax treatment of casual income under the Income-tax Act, 1961.*
9. *Mr. A has borrowed ₹ 5,00,000@10% for investment in shares of domestic companies and foreign companies. He earned dividend of ₹ 7,500 from domestic companies and ₹ 12,500 from foreign companies. He claimed that interest paid by him on money borrowed for investment is deductible from dividend income. Discuss whether the claim of Mr. A is valid in law.*
10. *Karan's bank account shows the following deposits during the financial year 2016-17. Compute his total income for the A.Y. 2017-18, assuming that his income from house property (computed) is ₹ 62,000.*

(i)	*Gift from his sister in Amsterdam*	*₹*	*2,30,000*
(ii)	*Gift from his friend on his birthday*	*₹*	*10,000*
(iii)	*Dividend from shares of various Indian companies*	*₹*	*12,600*
(iv)	*Gift from his mother's friend on his engagement*	*₹*	*25,000*
(v)	*Gift from his fiancée*	*₹*	*75,000*
(vi)	*Interest on bank fixed deposits*	*₹*	*25,000*

11. *Mr. Manas is a distributor of lottery tickets. He won ₹ 6,00,000 as prize money on unsold lottery tickets. It was offered as business income. The Assessing Officer wants to tax the same as lottery winning at the rate prescribed under section 115BB. Is he justified?*

Answer

10. ₹ 1,97,000

11. The issue under consideration is whether winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets can be subject to tax at the rate of 30% prescribed under section 115BB.

In *CIT v. Manjoo and Co. (2011) 335 ITR 527,* the Kerala High Court observed that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business.

The unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsalable and have no value except waste paper value and the distributor will get nothing on account of the tickets except any prize winning ticket if held by him, which, if produced will entitle him for the prize money.

Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls.

Therefore, the Kerala High Court held that the rate of 30% prescribed under section 115BB would be applicable on prize money winnings received by a distributor on unsold lottery tickets held by him.

Applying the rationale of the Kerala High Court ruling to the case on hand, the Assessing Officer's intention to tax the prize money received by the distributor on unsold lottery tickets held by him at the rate prescribed under section 115BB is justified.

9

Income of other Persons included in Assessee's Total Income

Question 1

Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2016 was ₹ 5 lacs, out of which ₹ 3 lacs was contributed out of her own sources and ₹ 2 lacs was contributed out of gift from her husband.

As further capital was needed by the firm, she further invested ₹ 2 lacs on 01.05.2016 out of the funds gifted by her husband. The firm paid interest on capital of ₹ 80,000 and share of profit of ₹ 60,000 for the financial year 2016-17.

Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions.

Answer

As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises, directly or indirectly, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of ₹ 3 lacs out of her own resources to the capital of the firm.

As per *Explanation 3* to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of ₹ 32,000 i.e., ₹ 80,000 x ₹ 2,00,000/ ₹ 5,00,000.

Share of profit amounting to ₹ 60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: *It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% p.a.*

Question 2

Mr. A has gifted a house property valued at ₹ 50 lakhs to his wife, Mrs. B, who in turn has gifted the ·same to Mrs. C, their daughter-in-law. The house was let out at ₹ 25,000 per month throughout the year. Compute the total income of Mr. A and Mrs. C.

Will your answer be different if the said property was gifted to his son, husband of Mrs. C?

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred.

Therefore, in this case, Mr. A would be the deemed owner of the house property transferred to his wife Mrs. B without consideration.

As per section 64(1)(vi), income arising to the son's wife from assets transferred, directly or indirectly, to her by an individual otherwise than for adequate consideration would be included in the total income of such individual.

Income from let-out property is ₹ 2,10,000 [i.e., ₹ 3,00,000, being the actual rent calculated at ₹ 25,000 per month *less* ₹ 90,000, being deduction under section 24@30% of ₹ 3,00,000]

In this case, income of ₹ 2,10,000 from let-out property arising to Mrs. C, being Mr. A's son's wife, would be included in the income of Mr. A, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. C.

In case the property was gifted to Mr. A's son, the clubbing provisions under section 64 would not apply, since the son is not a minor child. Therefore, the income of ₹ 2,10,000 from letting out of property gifted to the son would be taxable in the hands of the son.

It may be noted that the provisions of section 56(2)(vii) would not be attracted in the hands of the recipient of house property, since the receipt of property in each case was from a "relative" of such individual. Therefore, the stamp duty value of house property would not be chargeable to tax in the hands of the recipient of immovable property, even though the house property was received by her or him without consideration.

Note - *The first part of the question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of ₹ 2,10,000 arising to Mrs. C in the hands of Mr. A. [without first applying the provisions of section 27(i) to deem Mr. A as the owner of the house property transferred to his wife Mrs. B without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son's wife from indirect transfer of assets to her by her husband's parent, without consideration. Gift of house property by Mr. A to Mrs. C, via Mrs. B, can be viewed as an indirect transfer by Mr. A to Mrs. C.*

Question 3

Mr. Korani transferred 2,000 debentures of ₹ 100 each of Wild Fox Ltd. to his wife Mrs. Rekha Korani on 3.10.2014 without consideration. The company paid interest of ₹ 30,000 in September, 2015 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2016 Kartar Finance Co. paid interest of ₹ 3,000 upto March, 2017. How would both the interest income be charged to tax in A.Y. 2017-18?

Answer

As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any further income derived on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), ₹ 30,000, being the interest on debentures received by Mrs. Rekha Korani in September, 2016 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2014.

However, the interest of ₹ 3,000 upto March, 2017 earned by Mrs. Rekha Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

Question 4

Mr. Rose, out of his own funds, had taken an FDR for ₹ 10,00,000 bearing interest @ 10% p.a. payable half-yearly in the name of his wife Lilly. The interest earned during the financial year 2016-17 of ₹ 1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31.03.2017. How shall the interest on FDR and income from business be taxed for the Assessment Year 2017-18?

Answer

Section 64(1)(iv) specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of ₹ 1 lac on the FDR of ₹ 10 lacs for the F.Y.2016-17 shall be clubbed with the income of Mr. Rose.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor *[CIT v. M.S.S.Rajan (2001) 252 ITR 126 (Mad)]*.

Question 5

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of ₹ 10,000. The Assessing Officer while admitting that the salary is an *admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands.*

Discuss the correctness of the action of the Assessing Officer.

Answer

This question is based on the principles laid down by Madras High Court in the case of *CIT v. Smt. R.Bharati (1999) 240 ITR 697* where the interpretation of the terms "professional qualifications" and "knowledge" came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

Applying the rationale of the Madras High Court ruling, a model, having skill, competence and experience in her line can be considered as a professional. Hence, the action of the Assessing Officer is not correct.

Question 6

Mayur gifted amount of ₹ 5,00,000 to the wife of his brother which was used by her for the purchase of a house and simultaneously, on the same day, Mayur's brother gifted shares owned by him in a foreign company worth ₹ 5,00,000 to the minor son of Mayur. What will be the impact of such transfers in the hands of both the transferors and the transferees?

Answer

In the given case, Mayur is making a gift of ₹ 5,00,000 to the wife of his brother for the purchase of a house by her and simultaneously, his brother is making a gift to the minor son of Mayur, shares owned by him in a foreign company worth ₹ 5,00,000. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

The Supreme Court has, in *CIT vs. Keshavji Morarji (1967) 66 ITR 142*, held that if two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted.

Accordingly, the income arising to the wife of Mayur's brother from the house property would be included in the total income of his brother and the dividend from shares transferred to Mayur's minor son would be taxable in the hands of Mayur. This is because both Mayur and his brother are the indirect transferors of the income yielding assets to their minor child and spouse, respectively, with an intention to reduce their burden of taxation.

However, since husband's brother and father's brother fall within the definition of "relative" under Section 56(2)(vii), hence , the sum of money and property, respectively, received from them would be exempt in the hands of the concerned transferee.

Question 7

Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14-6-2016. On 12-7-2016, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and wife of Mr. Vasudevan's brother on 01-8-2016 at 9% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Vasudevan and his brother.

Answer

In the given case, Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14.06.2016 and simultaneously, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife on 12.07.2016. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and his brother's wife. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in *CIT vs. Keshavji Morarji (1967) 66 ITR 142*.

Accordingly, the interest income arising to Mrs. Vasudevan in the form of interest on fixed deposits would be included in the total income of Mr. Vasudevan and interest income arising in the hands of his brother's wife would be taxable in the hands of Mr. Vasudevan's brother as per section 64(1), to the extent of amount of cross transfers i.e. ₹ 5 lakhs.

This is because both Mr. Vasudevan and his brother are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

Therefore, the interest income earned by his spouse on fixed deposit of ₹ 5 lakhs alone would be included In the hands of Mr. Vasudevan's brother and not the interest income on the entire fixed deposit of ₹ 6 lakhs, since the cross transfer is only to the extent of ₹ 5 lakhs.

Question 8

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y. 2017-18:

Interest of ₹ 20,000 on bank FDRs received by minor son of Rajesh. These FDRs were made by the minor son out of his earnings from stage acting.

Answer

According to section 64(1A), all income accruing or arising to a minor is to be included in the income of his parent, whose total income [excluding the income includible under section 64(1A)] is higher. The income derived by the minor from manual work or from any activity involving his skill, talent or specialised knowledge or experience will not be included in the income of his parent.

Since interest of ₹ 20,000 on bank FDRs received by minor son of Rajesh does not arise to minor on account of his manual work or on account of an activity involving his skill, talent or specialized knowledge or experience, therefore, such interest should be included in income of Mr. Rajesh or Mrs. Rajesh, whosoever total income (before including minor's income) is higher. However, exemption of ₹ 1,500 under section 10(32) shall be provided from interest of ₹ 20,000 to be clubbed.

Question 9

Antaryami settled 1/4th share of his property under a trust for the education and maintenance of his minor daughter, Poulomi. Under the terms of the trust deed, the income accruing to the trust, after meeting the expenses of maintenance and education of Poulomi, was to be accumulated and paid over to her on her attaining majority. The Assessing Officer assessed the income arising from 1/4th share of the property, settled for the benefit of Poulomi, in the hands of Antaryami. Examine the correctness of the assessment.

Answer

As per section 64(1A), the income of a minor child should be included in the total income of that parent, whose total income before such inclusion is higher.

The Supreme Court, in *CIT v. M.R. Doshi (1995) 211 ITR 1*, held that where the income from the trust was to be accumulated until the child attained majority, the clubbing provisions would not get attracted, since no benefit accrues to the minor child during the period when such child is a minor.

However, in this case, the minor daughter Paulomi is eligible for the benefits during the period when she is a minor, since income from the trust is being used for meeting her education and maintenance expenses. Only the remaining income is to be accumulated and paid over to her on her attaining majority. Therefore, since benefit under the terms of the trust deed is accruing, even though to a limited extent, to the minor daughter Paulomi during the period when she is a minor, the ratio applicable in the Supreme Court decision cited above cannot be applied in this case. Accordingly, the clubbing provisions under section 64(1A) will get attracted.

Therefore, the stand taken by the Assessing Officer to tax the income in the hands of Antaryami is correct. However, only so much of income as is used for meeting the education and maintenance expenses of Paulomi during the current year should be clubbed in the hands of Antaryami after providing for an exemption of ₹1,500 under section 10(32) assuming that Antaryami's total income is greater than his spouse's total income.

Question 10

H, a mentally retarded minor, has a total income of ₹ 1,20,000 for the assessment year 2017-18. The total income of his father L and of his mother R for the relevant assessment year is ₹ 3,40,000 and ₹ 2,80,000, respectively. Discuss the treatment to be accorded to the total income of H for the relevant assessment year.

Answer

Section 64(1A) provides that all income accruing or arising to a minor child has to be included in the income of that parent, whose total income is greater. However, the income of a minor child suffering from any disability of the nature specified in section 80U shall not be included in the income of the parents but shall be assessed in the hands of the child. Thus, the total income of H has to be assessed in his hands and cannot be included in the total income of either his father or his mother.

Question 11

In the following cases discuss whether the loss could be set off:

(i) *Smt. Shanti carried on business with gifted funds of her husband Mahesh. For the financial year 2016-17, Shanti incurred loss of ₹ 2 Lacs which loss Mahesh wants to set-off from his taxable income.*

(ii) *Smt. Bhanu succeeded to the business of her husband Sri. Bhavesh who died on 10^{th} September, 2016. She carried on the business as proprietrix. The business of Bhavesh upto the date of his death resulted in a loss. Smt. Bhanu earned profit in business for the period ending 31.03.2017. Bhanu wants to set off the loss of her husband for the period ending 10^{th} September, 2016 against her income.*

Answer

(i) Under section 64(1)(iv), where any asset is transferred directly or indirectly to the spouse by an individual, otherwise than for adequate consideration or in connection with an agreement to live apart, the income arising therefrom is included in the hands of the transferor. The term "income" in this context includes "loss" as well. Therefore, the loss sustained by Shanti in the business carried on by her with funds gifted by her husband can be set off by her husband.

(ii) Section 78(2) says that where any person carrying on any business or profession is succeeded in such capacity by another person otherwise than by inheritance, no person other than the person incurring the loss is entitled to carry forward the loss and set it off against his income.

The facts of the case seem to indicate that Smt. Bhanu has succeeded to the business by inheritance and is not affected by the provisions of section 78(2). Therefore, she is eligible to carry forward and set off the loss of her husband against her own income. Succession by inheritance is an exception to the general bar contained in section 78(2) against carry forward and set off of losses of predecessor.

Question 12

Mr. Siddharth was a partner in a firm, representing his HUF, holding 25% of the share in the firm. His wife Vineeta, a house lady, was admitted in her individual capacity in the firm for 25% share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Siddharth-HUF by invoking section 64 of the Act.

Answer

As per section 64(1)(ii), in computing the total income of any "individual", the remuneration paid to spouse by a firm in which the individual has substantial interest shall be liable for clubbing. In the present case, Mr. Siddharth is not a partner in his individual capacity, but a partner in representative capacity.

The Supreme Court has, in the case of *CIT vs. Om Prakash (1996) 217 ITR 785,* held that an individual can be a partner in a partnership firm in his individual capacity or in the capacity of the Karta of a Hindu undivided family or, for that matter, in any other capacity, e.g., as a trustee. Where a person is a partner as the Karta of a Hindu undivided family, the capacity in which he is a partner in the partnership firm is relevant as between him and the other members of the Hindu undivided family. The income the Karta receives as a partner is not his individual income; it is the income of the Hindu undivided family and he receives it on behalf of the Hindu undivided family. It is for this reason that the income of the wife arising from her membership of the partnership firm, is held not includible in the income of the Hindu undivided family since the total income of the Hindu undivided family is not the total income of the individual (husband). For section 64(1) to get attracted, it is necessary that the spouse should be a partner in a partnership firm in his individual capacity. It is not attracted where he is a partner as the Karta of the Hindu undivided family to which his wife belongs.

The action of the Assessing Officer in this case is, therefore, not correct.

Question 13

Dinesh, an individual engaged in the business of finance, advances ₹ 5 lacs to his HUF on interest at 12% p.a., which is the prevailing market rate. The HUF invests the amount in its business and earns profit of ₹ 2 lacs from this money. Can the Assessing Officer add a sum of ₹ 1,40,000 (i.e. ₹ 2,00,000-₹ 60,000) as income of Dinesh under section 64(2) of the Income-tax Act, 1961?

Answer

Section 64(2) shall be applicable only where an individual member of HUF converts his property into the property of HUF or throws it into the common stock of the HUF without adequate consideration.

In this case, Dinesh does not transfer money to his HUF but only lends an amount of ₹ 5 Lacs to his HUF at an interest of 12%, which is the prevailing market rate. This is a transaction of loan, which pre-supposes, repayment. Dinesh continues to be the owner of the amount lent. Thus, there is no transfer of property from Dinesh to the HUF. Therefore, the Assessing Officer cannot add the profit arising to HUF in the total income of Dinesh by invoking section 64(2).

Question 14

Mr. Ghosh held 15% equity shares in ABC Ltd., a private limited company. He gifted all the shares held by him in ABC Ltd., to his wife Mrs. Ghosh on 25/5/2016. The transfer was made without adequate consideration. On 20/6/2016, Mrs. Ghosh obtained a loan of ₹ 80,000 from ABC Ltd., when the company's accumulated profit was ₹ 50,000. What are the tax implications of the above transactions?

Answer

Under section 2(22)(e), any payment by a closely-held company by way of loan or advance to its shareholder, being a person who is the beneficial owner of shares, holding not less than 10% of the voting power, is deemed as dividend to the extent to which the company possesses accumulated profits.

Therefore, in order to attract the deeming provisions under section 2(22)(e), the recipient of loan should be a registered shareholder as well as the beneficial owner of shares.

Accordingly, in this case, ₹ 50,000 (i.e., loan to the extent of accumulated profits of ABC Ltd.) would be deemed as dividend in the hands of Mrs. Ghosh, who holds 15% equity shares in ABC Ltd., under section 2(22)(e).

Thereafter, the clubbing provisions under section 64(1)(iv) would be attracted, as per which, income as arises, directly or indirectly, from asset transferred to spouse, otherwise than for adequate consideration, would be included in the hands of the transferor.

If the assets so transferred are shares in a company, the loan taken from the company is deemed as dividend income of the shareholder under section 2(22)(e) to the extent to which the company possesses accumulated profits. Thus, on account of this deeming provision, such loan is treated as income arising from the shares. It was so held by the Madras High Court in *CIT v. Vimalan (A.) (1975) 98 ITR 529.*

Accordingly, as per section 64(1)(iv), such income arising in the hands of the shareholder, Mrs. Ghosh, by virtue of section 2(22)(e) (i.e., deemed dividend of ₹ 50,000) would be included in the total income of Mr. Ghosh, who had transferred the said shares to Mrs. Ghosh without consideration.

Question 15

Mr. Ravi has gifted his only house property to his wife, Mrs. Ravi, and his married daughter, Mrs. Divya. The Assessing Officer has served a notice of demand on Mr. Ravi for payment of tax for the income derived from the said house property. Examine the validity of the Assessing Officer's action.

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter shall be deemed to be the owner of the house property so transferred.

Mr. Ravi, in this case, would be the deemed owner only in respect of the share of house property transferred to his wife Mrs. Ravi without consideration and not for the share of the house property transferred to his married daughter Mrs. Divya, even if she is a minor.

Since Mr. Ravi is the deemed owner of the share of house property transferred to his wife without consideration, the income derived from the house property, to the extent attributable to the share of property transferred to his wife without consideration, would be taxable in his hands under the head "Income from house property".

As per section 65, the notice of demand can, however, be served on Mrs. Ravi for payment of that portion of tax levied on Mr. Ravi attributable to the income derived [by virtue of section 27(i)], from the share of house property transferred to Mrs. Ravi, and standing in her name.

However, the income derived from house property, attributable to the share of property transferred to his married daughter without consideration, would be taxable in the hands of his daughter. Such income would not be taxable in the hands of Mr. Ravi. Mr. Ravi will not be responsible for the payment of tax attributable to aforesaid share of income of daughter from house property.

Thus, the action of the Assessing Officer in serving notice of demand on Mr. Ravi for payment of tax for the entire income derived from the said house property is not valid.

Exercise

1. *Write short notes on the following in the context of clubbing of income -*
   a) *Substantial interest*
   b) *Transfer and revocable transfer.*
2. *Under what circumstances can an income arising to the spouse of an individual be included in the income of the individual? Discuss.*
3. *State when the income arising to the son's wife can be included in the hands of the individual.*

4. *Discuss the provisions of the Income-tax Act, 1961, regarding inclusion of the income of minor child in the assessment of the parent. Enumerate the exception to this provision.*

5. *Write a short note on cross transfers, explaining the meaning and tax treatment of the same, in the context of clubbing of income.*

6. *Discuss the tax consequences arising on conversion of self-acquired property into joint family property.*

7. *A proprietary business was started by Smt. Poorna in the year 2013. As on 1.4.2015, her capital in business was ₹ 3,00,000.*

   Her husband gifted ₹ 2,00,000, on 10.4.2015, which amount Smt. Poorna invested in her business on the same date. Smt. Poorna earned profits from her proprietary business for the P.Y.2015-16, ₹ 1,50,000 and P.Y.2016-17, ₹ 3,90,000. Compute the income to be clubbed in the hands of Poorna's husband for the A.Y.2017-18 with reasons.

8. *Mr. Ram has a salary income (computed) of ₹ 2,50,000 for the P.Y.2016-17. His minor son, Arjun, has agricultural income of ₹ 1,20,000 for the same year. The Assessing Officer clubbed the income of the minor son for determining the rate of income-tax applicable to Mr. Ram. However, Mr. Ram contended that agricultural income was exempt under section 10 and also not specified in the definition of income under section 2(24). Therefore, agricultural income of minor son should not be clubbed and the provisions of section 64(1A) are not attracted in this case. Discuss the correctness or otherwise of Mr. Ram's contention.*

Answers

7. ₹ 1,20,000

8. The facts of the case are similar to the case of *Suresh Chand Talera v. Union of India (2006) 152 Taxman 348/282 ITR (341) (M.P).* In this case, the High Court observed that the definition of income under section 2(24) is inclusive and not exhaustive. Hence, the fact that agricultural income has not been specified as one of the items in section 2(24) does not mean that agricultural income is not included in the word "income" wherever the word "income" has been used in the Act. Section 10 of the Act provides that in computing the income of the previous year of a person, any income falling in any of the clauses mentioned therein shall not be included. The first clause mentioned therein is "agricultural income". Thus, section 10 makes it clear that agricultural income is income but by express provision therein, agricultural income has been excluded from the total income of an assessee for the purpose of levy of income-tax. Section 4(1), which is the charging section, provides that while the total income of a person is to be determined in accordance with the provisions of the Income-tax Act, 1961, the rate or rates at which such income-tax will be paid on such income for any assessment year will be stipulated in the relevant Finance Act. The Annual Finance Act provides [under Chapter II section 2] that the net agricultural income shall be taken into account in the manner provided therein for the purpose of determining the rates of income-tax applicable to the income of the assessee. Therefore, in view of the above provisions, the High Court held that agricultural income of the minor son of the assessee has to be included in the income of the assessee for the purpose of determining the rate of income-tax applicable to the income of the assessee.

Therefore, in this case, the contention of Mr. Ram is incorrect. The agricultural income of his minor son, Arjun, has to be included in the income of Mr. Ram for rate purposes, since the words "income as arises or accrues to his minor child" used in section 64(1A) includes agricultural income also.

10

Set Off and Carry Forward of Losses

Question 1

X carrying on a business as sole proprietor, died on 31st March, 2016. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2016, a determined business loss of ₹ 5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 5 lacs of X.

Question 2

Can the brought forward business losses and unabsorbed depreciation be set off against the profit determined under section 44B?

Answer

The provisions of section 44B, introduced w.e.f. 1.4.1976, requiring computation of income of a non-resident from shipping business on a presumptive basis are mandatory and not optional. Therefore, there is no possibility of having a business loss where income is computed on presumptive basis under section 44B. There is an inbuilt presumption that the business losses and depreciation mentioned in the question relate to another business of the non-resident and not the shipping business. In such a case, both business loss and unabsorbed depreciation of another business can be set-off against the profits determined under section 44B in respect of shipping business.

Even though the provisions of section 44B are applicable "notwithstanding anything to the contrary contained in sections 28 to 43A", it is possible to take a view since the *non obstante* clause is relevant only for computation of income from shipping business under section 44B, it does not bar set-off of unabsorbed depreciation relating to some other business.

Question 3

ABC Limited was amalgamated with XYZ Limited on 01.04.2016. All the conditions of section 2(1B) were satisfied.

ABC Limited has the following carried forward losses as assessed till the Assessment Year 2016-17:

	Particulars	***₹(in lacs)***
(i)	*Speculative Loss*	*4*
(ii)	*Unabsorbed Depreciation*	*18*
(iii)	*Unabsorbed expenditure of capital nature on scientific research*	*2*
(iv)	*Business Loss*	*120*

XYZ Limited has computed a profit of ₹ 140 lacs for the financial year 2016-17 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on ₹ 150 lacs, being the consideration at which plant and machinery were transferred to XYZ Limited. The written down value as per income-tax record of ABC Limited as on 31st March, 2016 was ₹ 100 lacs.

The above profit of XYZ Limited includes speculative profit of ₹ 10 lacs.

Compute the total income of XYZ Limited for Assessment Year 2017-18 and indicate the losses/other allowances to be carried forward by it.

Answer

Computation of total income of XYZ Limited for the A.Y. 2017-18

Particulars	**₹(in lacs)**	
Business income		
Business income before setting-off brought forward losses of ABC Ltd.		140
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.		
Value at which assets are transferred by ABC Ltd.	150	

WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [₹ 50 lacs × 15 %] [*Explanation 2* to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of ABC Ltd. (See Notes 2 & 4)		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A (See Notes 2 & 4)		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) (See Note 5)		(2.00)
		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of ₹ 4 lacs of ABC Ltd. cannot be carried forward by XYZ Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.
5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.
6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses

against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the F.Y. 2017-18.

Question 4

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y.2017-18:

A loss of ₹ 85,000 was sustained by Simran in the activity of owning and maintaining camels for races.

Answer

Sec 74A(3) lays down the provisions for set-off and carry forward of loss from the activity of owning and maintaining race horses. According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses. Since the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and maintaining camels is not covered under section 74A(3).

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 72 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

Question 5

Explain the conditions which are required to be fulfilled by the predecessor and successor co-operative banks in order to claim benefit of section 72AB.

Answer

The benefit of carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in case of business re-organisation of co-operative banks would be available under section 72AB only on fulfillment of the following conditions -

(a) Conditions to be fulfilled by the predecessor bank

(1) it should have been engaged in the business of banking for three or more years; and

(2) it should have held at least three-fourths of the book value of fixed assets as on the date of the business re-organisation, continuously for two years prior to the date of business re-organisation.

(b) Conditions to be fulfilled by the successor bank

(1) it should hold at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business re-organisation, continuously for a minimum period of five years immediately succeeding the date of business re-organisation;

(2) it continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business re-organisation; and

(3) it fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor cooperative bank or to ensure that the business re-organisation is for genuine business purpose.

Question 6

M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2016. The assessed business loss of the firm for the assessment year 2016-17 which it is entitled to carry forward amounts to ₹ 3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2016 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.

Compute the amount of business loss relating to the assessment year 2016-17, which the firm is entitled to set off against its business income for the assessment year 2017-18. The business income of the firm for the assessment year 2017-18 is ₹ 3,30,000. Your answer should be supported by reasons.

Answer

The firm is entitled to set off its brought forward business loss amounting to ₹ 3,60,000 relating to the assessment year 2016-17 to the extent of ₹ 3,30,000 against its business income of ₹ 3,30,000 for the assessment year 2017-18, as per the provisions of section 72(1).

The balance unabsorbed business loss of ₹ 30,000 relating to the assessment year 2016-17 will be carried forward to assessment year 2018-19.

Section 78(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. **It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners.** Therefore, section 78(1) is not applicable to the case of M/s. JKLM.

Question 7

An assessee sustained a loss under the head "Income from house property" in the previous year relevant to the assessment year 2016-17, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee *carry forward such loss for set off against income from house property of the assessment year 2017-18?*

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads "Profits and gains of business or profession" or "Capital gains" should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head "Income from house property" in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.

Question 8

M, an individual, was carrying on a business as sole proprietor. On his death, his legal heirs decide to continue the same business by forming a firm.

At the time of death, M had a determined business loss of ₹ 2 Lacs, under the provisions of the Income-tax Act, 1961 to be carried forward.

Does the firm, consisting of all the legal heirs of M, get a right to have this loss adjusted against its current income? Discuss.

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that the only exception is when the business passes on to another by inheritance.

The Apex Court, in *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, has held that where the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor should be made available to the firm.

In this case, the business of M was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 2 Lacs of M.

Question 9

A private limited company has share capital in the form of equity share capital. The shares were held up till 31st March, 2015 by four members A, B, C and D equally. The company made losses/profits for the past three assessment years as follows:

Assessment Year	*Business Loss ₹*	*Unabsorbed Depreciation ₹*	*Total ₹*
2013-14	*Nil*	*15,00,000*	*15,00,000*
2014-15	*Nil*	*12,00,000*	*12,00,000*
2015-16	*9,00,000*	*9,00,000*	*18,00,000*
Total	*9,00,000*	*36,00,000*	*45,00,000*

The above figures have been accepted by the tax department.

During the previous year ended 31.3.2016, A sold his shares to Y and during the previous year ended 31.3.2017, B sold his shares to Z. The profits for the past two previous years are as follows:

31.3.2016 ₹ 18,00,000 (before charging depreciation of ₹ 9,00,000)

31.3.2017 ₹ 45,00,000 (before charging depreciation of ₹ 7,50,000)

Compute taxable income for A.Y.2017-18. Workings must form part of your answer.

Answer

A, B, C and D are the four shareholders of a private limited company. The shareholding pattern of the company in the last three financial years are given below:

As on 31st day of March	A	B	C	D	Y	Z
	%	%	%	%	%	%
2015	25	25	25	25	-	-
2016	-	25	25	25	25	-
2017	-	-	25	25	25	25

Section 79 provides that, in case of a closely held company, no loss incurred in the previous year shall be carried forward and set off against the income of the subsequent previous year unless the shares carrying at least 51% of the voting power of the company are beneficially held on the last day of the previous year in which the loss is sought to be set off, by the same shareholders, who beneficially held the shares carrying at least 51% of the voting power on the last day of the previous year in which the loss was incurred.

Since shareholders holding at least 51% of the voting power are the same in the first and second year, the restriction imposed by section 79 is not applicable for the second year. Thus, the taxable income for the assessment year 2016-17 would be:

Particulars	₹
Business profit	18,00,000
Less: Current year's depreciation	9,00,000
	9,00,000
Less: Brought forward business loss [as per section 72(2)]	9,00,000
Taxable income	**Nil**

Unabsorbed depreciation relating to the earlier assessment years can be carried forward to the next assessment year i.e., A.Y. 2017-18. There is no brought forward business loss and section 79 is not applicable in case of carry forward of unabsorbed depreciation. Section 32 governs the carry forward and set off of depreciation for which the shareholding pattern is not relevant at all. Consequently, the income for A.Y.2017-18 will be determined as under -

Particulars	₹	₹
Business income		45,00,000
Less: Current year's depreciation		7,50,000
		37,50,000
Less: Unabsorbed depreciation:-		
Assessment year 2013-14	15,00,000	
Assessment year 2014-15	12,00,000	
Assessment year 2015-16	9,00,000	36,00,000
Taxable Income for A.Y.2017-18		**1,50,000**

Question 10

Rajesh & Co., the sole proprietary concern of Mr. Rajesh got converted into partnership after his death on 02.04.2016 by his two sons and the business of Rajesh & Co., was continued to be carried in the same manner. There were business losses of ₹ 4.25 Lacs till 31.03.2016. The net results of the business for the year ended 31.03.2017 were profits of ₹ 5 Lacs. The partners want to set off the losses of ₹ 4.25 Lacs from the profits of the firm. Can they do so?

Answer

The business of sole proprietary concern was converted into a partnership because of the death of the proprietor. His two sons, who are the legal heirs, continued the business. Section 78(2) provides that in the case of succession by inheritance, the successor can carry forward and set-off the loss of predecessor against his income. The Supreme Court, in the case of *CIT v. Madhukant M. Mehta [2001] 247 ITR* 805, has held that where the legal heirs of a deceased-proprietor enter into partnership and carry on the same business in the same premises under the same trade name, there is succession by inheritance as contemplated in section 78(2) and the assessee-firm is entitled to carry forward and set off the deceased's business loss against its income for subsequent years.

Therefore, the partnership firm formed by the two sons who inherited the business of Mr. Rajesh can set-off the loss of the predecessor i.e. sole-proprietary concern.

Question 11

X Ltd., a pharmaceutical company having accumulated losses and unabsorbed depreciation to be set off in future for ₹ 130 lacs and ₹ 250 lacs as on 31.3.2016 was demerged on 16.5.2016 and 30% of its total assets were transferred to the resulting company, XY Ltd. How shall the accumulated losses and unabsorbed depreciation of the demerged company be dealt with in the return for Assessment Year 2017-18 of the resulting company:

(i) When the same are not directly relatable to the undertakings transferred and

(ii) When the same are directly relatable to the undertakings transferred.

Answer

The accumulated business loss and unabsorbed depreciation of the demerged company shall be carried forward and set off by the resulting company under section 72A(4) in the following manner:

(i) Where such loss or unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, such loss shall be apportioned between the demerged company and the resulting company in the same proportion in which assets of the undertaking have been retained by the demerged company and transferred to the resulting company and shall be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be. In this case, therefore, 30% of ₹ 130 lacs and ₹ 250 lacs, shall be allowed to be carried forward and set off by the resulting company and the balance by the demerged company.

(ii) Where such loss or unabsorbed depreciation is directly relatable to the undertaking transferred to the resulting company, the entire loss or unabsorbed depreciation shall be allowed to be carried forward and set off in the hands of the resulting company. Accordingly, in such a case, the entire amount of ₹ 130 lacs and ₹ 250 lacs shall be allowed to be set off in the hands of the resulting company.

Question 12

Write short note on:

Carry forward and set off of losses in the event of change in shareholdings of companies in which public are not substantially interested.

Answer

Section 79 prescribes the condition for carry forward and set off of losses in the case of companies, not being companies in which the public are substantially interested. No loss incurred in any year prior to the previous year shall be carry forward and set off unless the persons who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which loss was incurred continue to be the shareholders on the last day of the previous year on which the loss is to be set off.

However, there are two situations where carry forward and set-off of losses is permitted without fulfilment of the above condition. They are:

(i) Where a change in the voting power takes place consequent upon the death of a shareholder or on account of transfer of share by way of gift to any relative of such shareholder.

(ii) Where a change in the voting power takes place in an Indian subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company provided 51% of the shareholders of the amalgamating or demerged company continue to be shareholders of the amalgamated or the resulting foreign company.

Exercise

1. *Write short notes on -*
   a) *Inter-head adjustment*
   b) *Inter-source adjustment.*
2. *Discuss the correctness of the following statements -*
   (i) *Long term capital loss can be set-off against short-term capital gains arising in that year.*
   (ii) *Business loss can be set-off against salary income arising in that year.*
3. *Discuss briefly on -*
   a) *Carry forward and set-off of losses by closely held companies*
   b) *Set-off and carry forward of speculation business loss.*
4. *State the conditions to be fulfilled by an amalgamated company for carry forward of the accumulated loss and unabsorbed depreciation of the amalgamating company.*
5. *Discuss the provisions of the Income-tax Act, 1961 regarding set-off and carry forward of the following losses -*
   a) *Loss under the head "Capital Gains"*
   b) *Loss from the activity of owning and maintaining race horses.*
6. *What are the conditions to be fulfilled to carry-forward and set-off losses in the event of change in shareholding of a company in which public are not substantially interested? State the situations when the carry-forward and set-off is permissible without such restrictions.*
7. *Write a short note on carry forward and set-off of losses in case of -*
   (a) *change in constitution of firm;*
   (b) *succession by inheritance; and*
   (c) *succession otherwise than by inheritance.*

11

Deductions from Gross Total Income

Question 1

Can the aggregate of the deductions under the various provisions of the Income-tax Act, 1961 exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be? Explain briefly the provisions introduced in section 80A of the Act in this regard to prevent abuse of tax incentives.

Answer

The profit-linked deductions in Chapter VI-A were susceptible to sizable manipulation by the taxpayers who have, in the past, resorted to claiming deduction under more than one section in respect of the same profits by taking advantage of the overlap of provisions of the different sections.

In order to prevent such manipulation by tax payers, section 80A provides that -

(1) the profits and gains allowed as deduction under section 10AA or under any provision of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" in any assessment year, shall not be allowed as deduction under any other provision of the Act for such assessment year.

(2) the deduction, referred to in (1) above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be.

(3) No deduction under any of the provisions referred to in (1) above, shall be allowed if the deduction has not been claimed in the return of income.

Question 2

Examine the correctness of the statement that "there exists no difference in the treatment of income claimed under section 10 with those claimed under Chapter VI-A of the Income-tax Act, 1961".

Answer

The statement is incorrect. Section 10 lists out the items of income which do not form part of total income. Thus, such incomes are fully or partly exempt from tax. Items of income which are exempt under section 10 shall not form part of any head of income. Therefore, the income which are claimed as exempt under section 10 are excluded from gross total income, in the sense, they are not included in the computation of gross total income. However, for claiming deduction under Chapter VIA, the income must be included under the respective head of income for computation of gross total income and thereafter, deduction can be claimed under the respective section as specified in Chapter VI-A to arrive at the total income. In short, section 10 provides for exemption of income whereas Chapter VI-A provides for deductions from gross total income.

Question 3

Mr. Srinivasan, aged 61 years, furnishes the following particulars for the year ending 31.03.2017:

(a) Life Insurance Premium paid – ₹ 30,000, actual capital sum of the policy assured for ₹ 1,20,000. The insurance policy was taken on 01.04.2011;

(b) Contribution to Public Provident Fund – ₹ 40,000 in the name of father;

(c) Tuition fee payment – ₹ 8,000 each for 2 sons pursuing full time graduation course in Calcutta; Tuition fee for daughter pursuing PHD in Kellogg University, USA – ₹ 2.50 Lacs;

(d) Housing loan principal repayment – ₹ 32,000 to Axis Bank. This property is under construction at Calcutta as on 31.03.2017;

(e) Principal repayment of housing loan taken from a relative – ₹ 70,000. The property is self-occupied situated at Pune;

(f) Deposit under Senior Citizens Savings Scheme – ₹ 15,000;

(g) Five-year deposits in an account under Post Office Time Deposit Scheme – ₹ 50,000;

(h) Investment in National Savings Certificate – ₹ 70,000;

Compute the deduction eligible under appropriate provisions of section 80C for A.Y. 2017-18.

Answer

Computation of eligible deduction under section 80C for A.Y.2017-18

Particulars	₹
Life Insurance Premium **(See Note 1)**	24,000
Contribution to Public Provident fund **(See Note 2)**	Nil
Tuition fee of 2 sons for graduation course **(See Note 3)**	16,000
Housing loan principal repayment **(See Notes 4 & 5)**	Nil
Senior Citizen Savings Scheme deposit **(See Note 6)**	15,000
Post Office Time Deposit Scheme **(See Note 6)**	50,000
Investment in National Savings Certificate	70,000
Total Investment	**1,75,000**
Eligible deduction under section 80C restricted to	1,50,000

Notes:

1. Any amount of life insurance premium paid in excess of the specified percentage of actual capital sum assured shall be ignored for the purpose of deduction under section 80C. In the given case, since the insurance policy has been issued before 1.04.2012, therefore 20% of actual capital sum assured i.e., ₹ 24,000 shall be allowed as deduction, whereas, the premium paid during the year is ₹ 30,000. Therefore, the excess premium of ₹ 6,000 does not qualify for deduction.
2. In the case of an individual, contribution to PPF can be made in his name or in the name of his spouse or children to qualify for deduction under section 80C. **As the contribution was made in the name of his father, deduction is not allowable.**
3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, ₹ 16,000 shall be allowed as deduction. **Tuition fee paid to an educational institution situated outside India is not eligible for deduction.**
4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.
5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been obtained from Central Government / State Government / bank / specified employer / institution.
6. The following investments are also eligible for deduction under section 80C:-
   (1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and
   (2) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

Question 4

Chand, an individual resident in India, paid medical insurance premium amounting to ₹ 20,000 by cash during the year ending 31.3.2017 out of his income chargeable to tax in respect of the policy taken on the health of his dependent father in accordance with the scheme framed by the General Insurance Corporation of India and approved by the Central Government.

Besides, he paid ₹ 90,000 during the year ending 31.3.2017 for the medical treatment of his dependent mother, aged 69 years, in respect of a disease specified in Rule 11DD(1) of the Income-tax Rules, 1962. He received ₹ 20,000 from the insurance company for the said medical treatment of his mother.

Chand seeks your advice on the deductions available in respect of these two payments.

Answer

Section 80D provides for deduction in respect of medical insurance premium paid by an individual or a Hindu undivided family subject to certain conditions and limitations. One of the conditions for allowance of the deduction is that the premium should be paid by any mode other than cash. Chand has paid the premium by cash and is, therefore, not eligible for deduction under section 80D.

However, Chand is eligible for deduction under section 80DDB in respect of the payment made by him during the relevant previous year for the medical treatment of his dependent mother in respect of the specified disease. The ceiling limit of deduction is ₹ 60,000 since the payment made is in respect of his dependent mother who is above 60 years of age.

Section 80DDB provides that the assessee shall be allowed a deduction of the amount actually paid for medical treatment of the specified disease or ₹ 60,000 (since the payment is in respect of a senior citizen), whichever is less, in respect of that previous year in which such amount was actually paid. The second proviso to that section provides that deduction under that section shall be reduced by the amount received under an insurance. From a combined reading of the section and the proviso, it can be inferred that in this case, ₹ 20,000, being the amount received from the insurer, should be deducted from ₹ 60,000, which is the deduction allowable as per section 80DDB (since it is lower than the amount of ₹ 90,000 actually paid). Therefore, ₹ 40,000 [i.e., ₹ 60,000 - ₹ 20,000] is the deduction available under section 80DDB.

Question 5

Expenditure on medical treatment of an assessee and members of his family constitute a major element of a household budget, particularly if he or a member of his family suffers from physical disability. Discuss the relevant provisions which provide relief or deductions available to a non-salaried person, in this respect.

Answer

Sections 80D, 80DD, 80DDB and 80U of Chapter VI-A of the Income-tax Act, 1961 provide deduction in respect of medical insurance premium paid/ medical expenditure incurred/ amount deposited with LIC or any other insurer approved by the IRDA.

Sections 80DD and 80U, which particularly provide for deduction in respect of a person with disability, are discussed hereunder -

(i) Under section 80DD, deduction is allowable to an individual or HUF, resident in India, in respect of any expenditure incurred for the medical treatment (including nursing), training and rehabilitation of a dependent with disability or a payment made to L.I.C. or any other insurer approved by the IRDA for the maintenance of a dependent with disability. The deduction under this section is ₹ 75,000, irrespective of the quantum of expenditure incurred or deposit made. The deduction is ₹ 1,25,000, where the dependent is a person with severe disability. The dependent should, however, not have claimed deduction under section 80U

(ii) Under section 80U, an individual who is a resident and who is certified by a medical authority to be a person with disability at any time during the previous year, shall be entitled to a deduction of ₹ 75,000. If it is a case of severe disability, deduction shall be ₹ 1,25,000. A copy of the certificate issued by the Medical authority is required to be furnished in respect of the assessment year for which the deduction is claimed along with the return of income.

Question 6

Mr. K, a resident, aged 63 years, has the following income during the previous year 2016-17:

- *Salary Income ₹ 6,80,000*
- *Interest on savings bank account with Allahabad Bank ₹ 16,000*

Other particulars given by Mr. K are as under:

(i) Insurance premium paid to Max Life Insurance Ltd. amounting to ₹ 25,000 under a policy taken on life of his son. The policy was taken on 20th July, 2011 and the sum assured is ₹ 1,80,000.

(ii) Insurance premium paid to Life Insurance Corporation of India amounting to ₹ 22,000 under a policy taken on his life on 20th April, 2012 and the sum assured is ₹ 2,00,000.

(iii) Premium of ₹ 28,000 paid by cheque on health insurance for self to National Insurance Corporation Ltd. and payment in cash of ₹ 5,000 to a hospital for preventive health check-up for self.

Compute the total income of Mr. K for A.Y. 2017-18 on the basis of the above particulars.

Answer

Computation of total income of Mr. K for the A.Y.2017-18

Particulars		**₹**	**₹**
Income from salaries			6,80,000
Income from Other Sources (Interest on savings bank account)			16,000
Gross Total Income			6,96,000
***Less*: Deductions under Chapter VI-A**			
Under section 80C (Life insurance premium paid)			
Premium paid in respect of policy taken on life of son *(See Note 1 below)*	25,000		
Premium paid in respect of policy taken on own life *(See Note 2 below)*	20,000	45,000	

Under section 80D (Medical insurance premium paid) *(See Note 3 below)*	30,000	
Under section 80TTA (Interest on savings bank account) *(See Note 4 below)*	10,000	85,000
Total Income		**6,11,000**

Notes:

(1) Mr. K can claim deduction under section 80C in respect of insurance premium paid by him in respect of a policy taken on the life of his son. Since the policy was issued before 1.4.2012, the premium paid shall be allowed as deduction upto 20% of sum assured (i.e., upto ₹ 36,000, being 20% of ₹ 1,80,000). Since the insurance premium of ₹ 25,000 paid is within this limit, the same is fully allowable as deduction under section 80C.

(2) In respect of premium of ₹ 22,000 paid by Mr. K to LIC under an insurance policy taken on his own life, the deduction under section 80C would be restricted to 10% of sum assured, since the premium is paid in respect of a life insurance policy taken on or after 1.4.2012. Therefore, the deduction under section 80C in respect of this policy would be restricted to ₹ 20,000, being 10% of ₹ 2,00,000.

(3) Deduction under section 80D is allowable in respect of health insurance premium paid by any mode other than cash and expenses on preventive health check-up (upto ₹ 5,000) paid by any mode, including cash. Therefore, both the premium of ₹ 28,000 paid by cheque and preventive health check-up of ₹ 5,000 paid by cash qualifies for deduction under section 80D. However, the deduction would be restricted to ₹ 30,000, which is the overall limit under section 80D in respect of a resident individual, who is of the age of 60 years or more at any time during the previous year.

(4) As per section 80TTA, deduction shall be allowed from the gross total income of an individual in respect of income by way of deposit in the savings bank account included in the assessee's gross total income, subject to a maximum of ₹ 10,000. Therefore, a deduction of ₹ 10,000 is allowable from the gross total income of Mr.K, even though his interest from savings bank account is ₹ 16,000.

Question 7

Ms. Madhvi, a resident individual and self-employed industrial designer, furnished the following particulars for the year ended 31-03-2017:

	Particulars	***₹***
i.	*Gross total income*	*5,00,000*
ii.	*Housing loan principal repayment. The property is under construction at Jaipur as on 31-03-2017.*	*1,10,000*
iii.	*Principal repayment of housing loan from a relative. This property is self-*	*50,000*

	occupied situated at Jodhpur.	
iv.	*Contribution to Public Provident Fund in the name of her mother.*	*70,000*
v.	*She deposited ₹ 5,000 per month in her account under a pension scheme notified by the Central Government.*	

Compute total income of Ms. Madhvi for the Assessment Year 2017-18 stating reasons for the deduction eligible under appropriate provisions of Chapter VI-A.

Answer

Computation of total income of Ms. Madhvi for the A.Y. 2017-18

Particulars	₹	₹
Gross Total Income		5,00,000
***Less:* Deductions under Chapter VI-A**		
Section 80C		
Principal repayment for housing loan taken for house property at Jaipur **[See Note 1]**	**Nil**	
Principal repayment for housing loan taken for house property at Jodhpur **[See Note 2]**	**Nil**	
Contribution to public provident fund in the name of mother **[See Note 3]**	**Nil**	
Section 80CCD		
Contribution to pension scheme notified by the Central Government **[See Note 4]**	60,000	60,000
Total income		**4,40,000**

Notes:

(1) As per the provisions of section 80C, the deduction for principal repayment of housing loan is provided only in respect of a house property whose income is chargeable to tax under the head 'Income from house property'. As the house property at Jaipur is still under construction, no income is chargeable to tax under the head "Income from house property". Hence, no deduction would be available under section 80C for principal repayment of the housing loan for property under construction at Jaipur.

(2) The deduction for principal repayment of housing loan under section 80C is provided only in respect of the loan taken from the institutions mentioned under section 80C (like banks, Life Insurance Corporation of India, National Housing Bank, specified employer etc.) However, loan from a relative does not qualify for deduction under section 80C. Since, in the present case, the loan is taken from a relative, no deduction would be

available under section 80C for the repayment of the principal in respect of self-occupied property at Jodhpur.

(3) The contribution to public provident fund is allowed as deduction only if it is in the name of specified persons mentioned in section 80C, namely, self, spouse or any child of such individual. Since mother of the individual is not a specified person as per section 80C, no deduction would be available for the contribution to public provident fund in the name of the mother.

(4) The deduction under section 80CCD(1) shall be an amount not exceeding 10% of the gross total income of in case of a self-employed individual. Therefore, the deduction in respect of deposit by Ms. Madhvi to the pension scheme notified by the Central Government ₹ 60,000 shall be limited to ₹ 50,000, being 10% of ₹ 5,00,000, under section 80CCD(1). Thereafter, the balance ₹ 10,000 can be claimed as deduction under section 80CCD(1B). It may be noted that deduction of upto ₹ 50,000 under section 80CCD(1B) is over and above the deduction under section 80CCD(1). Deduction under section 80CCD(1B) is not subject to the overall limit of ₹ 1,50,000 under section 80CCE.

Question 8

(a) Mr. Harsh, aged 42 years, furnishes the following information relating to premium on mediclaim policy paid by cheque for the year ending 31.03.2017:

(i) for self – ₹ 14,000;

(ii) for spouse, aged 35 years – ₹ 14,000;

(iii) for non-dependent father, aged 70 years - ₹ 32,000;

(iv) for dependent mother-in-law, aged 65 years - ₹ 11,000.

Compute his eligible deduction under section 80D for A.Y.2017-18. Would your answer be different, in case the premium was paid in cash?

(b) Mr. Ravi, a Cost Accountant, aged 58 years, derives ₹ 4,12,000 as taxable professional income. Income of Mr. Ravi from other sources is ₹ 21,000. He pays medical insurance premium of ₹ 31,000 for insuring the health of his non-dependant parents who are senior citizens; ₹ 26,000 for self and spouse and ₹ 4,000 for his sister. He incurs expenditure of ₹ 25,000 on medical treatment of his dependant mentally retarded (severe disability) brother in an approved hospital duly certified. He pays rent of ₹ 4,000 per month. Calculate his total income for the assessment year 2017-18.

Answer

(a) In the given case, Mr. Harsh has paid ₹ 28,000 in aggregate towards self and spouse's mediclaim premium, deduction in respect of which shall be restricted to ₹ 25,000. Mediclaim premium of ₹ 32,000 paid for insuring the health of his father, who is a senior citizen, is eligible for additional deduction of up to ₹ 30,000 even though his father is not dependent on him. Therefore, total deduction of ₹ 55,000 [i.e., ₹ 25,000 + ₹ 30,000] shall be allowed to Mr. Harsh under section 80D.

It may be noted that, ₹ 11,000 paid for dependent mother-in-law is not allowable, since the definition of the term 'family' does not include mother-in-law.

Section 80D requires payment of premium on health insurance by any mode other than cash. Since the payment is made by cheque, ₹ 55,000 is allowed as deduction.

In case the premium was paid in cash, the same would not be deductible under section 80D.

(b) Computation of total income of Mr. Ravi for the A.Y. 2017-18

Particulars	₹	₹
Professional income		4,12,000
Income from other sources		21,000
Gross Total Income		**4,33,000**
Less: **Deductions under Chapter VI-A**		
1. Medical insurance premium paid under section 80D – (₹ 25,000 + ₹ 30,000) **[See Note 1]**	55,000	
2. Expenditure for dependant mentally retarded - section 80DD **[See Note 2]**	1,25,000	
3. Rent paid under 80GG **[See Note 3]** – least of the following is eligible for deduction -		
(i) Excess of rent paid over 10% of total income (₹ 48,000 - ₹ 25,300) = ₹22,700		
(ii) 25% of total income = ₹ 63,250		
(iii) Ceiling limit ₹ 5,000 p.m. = ₹ 60,000	22,700	2,02,700
Total income		**2,30,300**

Notes -

(1) Medical insurance premium paid for self and spouse would qualify for deduction under section 80D subject to a maximum of ₹ 25,000.

Mediclaim insurance premium paid for parents shall qualify for additional deduction under section 80D, subject to a maximum of ₹ 30,000 (since they are senior citizens), irrespective of whether they are dependent or non-dependent on Mr. Ravi.

Medical insurance premium paid for insuring the health of sister does not qualify for deduction under section 80D, since sister does not fall within the definition of "family".

(2) Deduction under section 80DD is a flat amount of **₹ 1,25,000**, irrespective of the actual expenditure incurred in respect of a dependent, who is a **person with severe disability**. It is assumed that Mr. Ravi has furnished a copy of the certificate issued by the medical authority, in the prescribed form and manner, along with the return of income under section 139 in respect of A.Y.2017-18.

(3) Total income for the purpose of section 80GG would be -

	₹
Gross Total Income	4,33,000
Less : Deduction under sections 80D & 80DD	1,80,000
Total income	**2,53,000**

It is presumed that all the conditions for claim of deduction under section 80GG have been fulfilled by Mr. Ravi.

Question 9

Ayush, an employee with M/s Isomer Solutions Ltd., provides the following information relating to his income for the financial year 2016-17:

(i) He received salary ₹ 25,000 per month including conveyance allowance @ ₹ 2,500 per month for official purposes.

(ii) He deposited ₹ 2,500 per month in his account under a pension scheme notified by the Central Government.

(iii) He paid a sum of ₹ 60,000 during the year as interest on loan taken in April, 2014 from bank for higher studies of his daughter.

(iv) He paid health insurance premium for himself and for his family members ₹ 8,500 in cash and ₹ 9,000 by credit card.

(v) He invested ₹ 40,000 in notified bonds issued by NABARD in July, 2016.

(vi) Equity shares having fair market price of ₹ 1,00,000 (on the date of exercise of option) were allotted to him by the company at a concessional price of ₹ 20,000 on 30.5.2016, which were sold by him for ₹ 1,80,000 on 28.2.2017.

Compute the total income of Ayush for assessment year 2017-18 and give reasons for treatment to each of the items.

Answer

Computation of total income of Mr. Ayush for the Assessment Year 2017-18

Particulars	₹	₹
Salaries		
Gross salary received	3,00,000	
Add: Shares allotted at concessional price – fair market value less the amount recovered from the employee [Section 17(2)(vi)] (i.e. ₹ 1,00,000 minus ₹ 20,000)]	80,000	
	3,80,000	
Less: Conveyance allowance exempt under section 10(14) [See Note (i) below]	30,000	3,50,000

Capital gains [See Note (ii) below]		
Sale consideration of equity shares sold on 28.02.2017	1,80,000	
Less: Fair Market Value of shares on the date of exercise of option (i.e., 30.5.2016)	1,00,000	80,000
Gross Total Income		**4,30,000**
***Less:* Deduction under Chapter VIA**		
Under section 80C [See Note (iii) below]		
For investment in notified bonds of NABARD	40,000	
Under section 80CCD [See Note (iv) below]		
For deposit in pension scheme notified by Central Government	30,000	
Under section 80D [See Note (v) below]		
For payment of health insurance premium by credit card	9,000	
Under section 80E [See Note (vi) below]		
For payment of interest on loan taken from bank for higher studies of daughter	60,000	1,39,000
Total Income		**2,91,000**

Notes:

(i) Conveyance allowance received for official duties is fully exempt under section 10(14).

(ii) The value of any specified security or sweat equity shares allotted or transferred by the employer, free of cost or at a concessional rate to the employee would be treated as a perquisite in the hands of the employee. The value would be the fair market value of the specified security or sweat equity shares on the date on which the option is exercised by the employee as reduced by the amount actually paid by, or recovered from the employee in respect of such security or shares.

Consequently, section 49(2AA) provides that for the purpose of computing capital gains in the hands of the employee at the time of sale of such securities/shares by the employee, the cost of acquisition shall be the fair market value which has been taken into account for the purpose of computing the perquisite value in the hands of the employee.

(iii) Subscription to notified bonds issued by NABARD will qualify for deduction under section 80C(2)(xxii).

(iv) Section 80CCD provides for deduction of both employee's and employer's contribution to pension scheme notified by the Central Government. This deduction has been extended also to individuals employed by any other employer. However, if the amount contributed exceeds 10% of salary, then, the deduction under section 80CCD(1) would be restricted to 10% of salary. [As per *Explanation* to section 80CCD, 'salary' for this purpose would include dearness allowance if the terms of employment so provide, but excludes all other allowances and perquisites]. Therefore, "salary" for the purpose of section 80CCD would be ₹ 2,70,000 (₹ 3,00,000 – ₹ 30,000). Deduction under section 80CCD(1) would be restricted to ₹ 27,000, being 10% of ₹ 2,70,000. The balance ₹ 3,000 can be claimed as deduction under section 80CCD(1B). In the alternative, the entire ₹ 30,000 can be claimed as deduction under section 80CCD(1B), since the maximum limit thereunder is ₹ 50,000.

(v) For claiming deduction under section 80D, the payment of medical insurance premium has to be made by any mode other than cash. Hence, payment of ₹ 8,500 made in cash will not qualify for deduction under section 80D.

(vi) The deduction under section 80E available to an individual in respect of interest on loan taken for his higher education has been extended to include interest on such loan taken for higher education of his relative i.e. his or her spouse and children. Hence, interest on loan taken by Mr. Ayush from bank for the higher studies of his daughter is eligible for deduction under section 80E.

Question 10

With brief reasons answer the following in terms of Chapter VI-A of the Income-tax Act, 1961:

(i) Mr. Raju invested ₹ 60,000 in listed units of Rajiv Gandhi Equity Saving Scheme (RGESS) during the financial year 2016-17. How much he can claim deduction in respect of such investment?

(ii) Mr. Jaju deposited ₹ 65,000 with life insurance corporation for the maintenance of his mother who suffers from disability of 90%. She is wholly dependent on him. How much is deductible?

(iii) Mr. Shiva has gross total income of ₹ 3,75,000. He has given the following donations:

National Children's Fund	*₹ 25,000 - by cheque*
Prime Minister's Drought Relief Fund	*₹ 30,000 - by cheque*
National Blood Transfusion Council	*₹ 40,000 - by cash*
National Illness Assistance Fund	*₹ 20,000 - equally by cash and cheque.*

Compute the amount deductible under section. 80G.

(iv) Mr. Manoj, a computer software engineer, co-authored a book on advanced computer programming alongwith his friend. He received ₹ 4,10,000 as lump sum royalty in March, 2017. How much of royalty is taxable?

Answer

	Deduction (₹)	Reasons
(i)	25,000	As per section 80CCG, an assessee, being a resident individual

<table>
<tr><td></td><td></td><td>would be allowed a deduction in computation of total income of 50% of the amount invested in the listed equity shares or listed units of an equity oriented fund in accordance with Rajiv Gandhi Equity Saving Scheme, 2013, provided the gross total income of the assessee does not exceed ₹ 12 lakhs and he is a new retail investor.
Mr. Raju is eligible for deduction under section 80CCG of –
- ₹ 30,000, being 50% of ₹ 60,000 invested in listed units of Rajiv Gandhi Equity Saving Scheme; or
- ₹ 25,000,
whichever is lower.
It is assumed that the gross total income of Mr. Raju does not exceed ₹ 12 lakhs during the previous year 2016-17 and he is a new retail investor.</td></tr>
<tr><td>(ii)</td><td>1,25,000</td><td>As per section 80DD, an assessee, being an individual or HUF, who is resident in India during the previous year, and has –
- incurred any expenditure for medical treatment (including nursing), training and rehabilitation of person dependent on him, who is suffering from disability or
- paid or deposited any amount under a scheme framed by LIC or other insurer for the maintenance of a dependent, being a person with disability,
would be eligible for deduction of ₹ 75,000, in case the dependent is a person with disability. In case the dependent is a person with severe disability, the deduction under this section would be ₹ 1,25,000.
Mr. Jaju would be eligible for deduction under section 80DD since he has deposited money with LIC for maintenance of his mother, who suffers from severe disability (80% or more of one or more disabilities) and is wholly dependent on him.
A flat deduction of ₹ 1,25,000 would be available to him under section 80DD, irrespective of the amount deposited with LIC.</td></tr>
<tr><td>(iii)</td><td>60,000</td><td>Mr. Shiva would be eligible for deduction under section 80G in respect of the donations made during the previous year as follows:
<table>
<tr><th>Donation to</th><th>Amount of donation (₹)</th><th>Mode of donation</th><th>% of donation eligible for deduction</th><th>Amount of deduction (₹)</th></tr>
<tr><td>National Children's Fund</td><td>25,000</td><td>Cheque</td><td>100%</td><td>25,000</td></tr>
</table>
</td></tr>
</table>

<table>
<tr><td></td><td></td><td>
<table>
<tr><td>Prime Minister's Drought Relief Fund</td><td>30,000</td><td>Cheque</td><td>50%</td><td>15,000</td></tr>
<tr><td>National Blood Transfusion Council</td><td>40,000</td><td>Cash</td><td>100%</td><td>Nil
(Cash donation in excess of ₹ 10,000 would <u>not</u> qualify for deduction)</td></tr>
<tr><td>National Illness Assistance Fund</td><td>20,000</td><td>₹10,000 by cheque
&
₹10,000 by cash</td><td>100%</td><td>20,000
(The whole amount qualifies for deduction, since cash donation in this case does not exceed ₹ 10,000)</td></tr>
</table>
</td></tr>
<tr><td>(iv)</td><td>3,00,000</td><td>The entire royalty would be first included in Manoj's income under the head "Income from other sources".
Thereafter, Mr. Manoj is eligible for deduction from gross total income under section 80QQB, of the whole of the income derived by him on account of any lumpsum consideration in the form of royalty in respect of a book, being a work of literary or scientific nature, or ₹ 3,00,000, whichever is less.
Book on Advanced computer programming would fall within the description of work of literary or scientific nature [Dassault Systems K.K. In Re. (2010) 322 ITR 125 (AAR)].
In this case, the eligible deduction under section 80QQB would be the lower of ₹ 4,10,000, being the amount of lumpsum royalty received by Manoj or ₹ 3,00,000.
The net effect is that out of ₹ 4,10,000 included in Manoj's income, he can claim deduction of ₹ 3,00,000 under section 80QQB. The balance of ₹ 1,10,000 would form part of his total income.</td></tr>
</table>

Note – It has been assumed that Mr. Raju, Mr. Jaju and Mr. Manoj are resident Indians.

Question 11

From the following details, compute the total income of Mr. A, Mr. B and Mr. C for A.Y.2017-18 –

	Particulars	Mr. A ₹	Mr. B ₹	Mr. C ₹
(i)	Salary (computed)	9,25,000	10,45,000	11,15,000
(ii)	Interest income (on fixed deposits)	75,000	85,000	95,000

Mr. A, Mr. B and Mr. C are new retail investors who have made the following investments in equity shares/units of equity oriented fund of Rajiv Gandhi Equity Savings Scheme, 2013 for the P.Y.2016-17:

	Particulars	Mr. A ₹	Mr. B ₹	Mr. C ₹
(i)	Investment in listed equity shares	15,000	62,000	23,000
(ii)	Investment in units of equity-oriented fund	30,000	-	25,000

The particulars of their other investments/payments made during the P.Y.2016-17 are given hereunder -

	Particulars	₹
(1)	Deposit in Public Provident Fund (PPF) by Mr. A	1,50,000
(2)	Life insurance premium paid by Mr. C, the details of which are as follows -	

	Date of issue of policy	Person insured	Actual capital sum assured (₹)	Insurance premium paid during 2016-17 (₹)
(i)	14/5/2011	Self	1,00,000	25,000
(ii)	11/6/2012	Spouse	1,25,000	15,000
(iii)	31/7/2013	Handicapped Son (section 80U disability)	2,00,000	40,000

(3)	**Payment of medical insurance premium by the following persons to insure their health:**	

Payer	Amount in ₹	Mode of payment
Mr. A (aged 55 years)	30,000	Account payee cheque
Mr. B (aged 52 years)	15,000	Cash
Mr. C (aged 48 years)	20,000	Crossed cheque

(4)	Mr. B paid interest on loan taken for the purchase of house in which he currently resides. He is claiming benefit of self-occupation under section 23(2) in respect of this house. He does not own any other house.	2,20,000
	Repayment of principal amount of loan taken for purchase of the said house	1,70,000
(5)	Contribution by Mr.A by cheque to National Children's Fund during the year.	30,000
(6)	Mr. B makes the following donations during the P.Y.2016-17 -	
	Donation to BJP by crossed cheque	50,000
	Donation to Electoral trust by cash	50,000

What would be the tax consequence if Mr. A and Mr. C sold their entire investment in units of equity oriented fund in May 2017?

Answer

Computation of total income for A.Y.2017-18

	Particulars	Mr. A ₹	Mr. B ₹	Mr. C ₹
	Salary	9,25,000	10,45,000	11,15,000
	Income from house property ***[See Note 5]***		(2,00,000)	
	Income from other sources (Interest)	75,000	85,000	95,000
(A)	**Gross total income**	**10,00,000**	**9,30,000**	**12,10,000**
	Less: **Deductions under Chapter VIA**			
	Under section 80C			
	Deposit in PPF (restricted to maximum ₹1,50,000) ***[See Note 4]***	1,50,000		
	LIC premium paid ***[See Note 1]***			62,500
	Principal repayment of housing loan (restricted to ₹1,50,000) ***[See Note 5]***		1,50,000	
	Under section 80CCG			
	Investment in listed equity shares/ units of			

	equity oriented fund of Rajiv Gandhi Equity Savings Scheme ***[See Note 2]***	22,500	25,000	Nil
	Under section 80D			
	Medical insurance premium ***[See Note 3]***	25,000	Nil	20,000
	Under section 80EE			
	Interest on housing loan ***[See Note 5]***		20,000	
	Under section 80G			
	Contribution to National Children's Fund ***[See Note 6]***	30,000		
	Under section 80GGC ***[See Note 7]***			
	Donation to BJP by crossed cheque		50,000	
	Cash donation to Electoral Trust		Nil	
(B)	**Total deduction under Chapter VIA**	**2,27,500**	**2,45,000**	**82,500**
(C)	**Total Income (A) – (B)**	**7,73,000**	**6,85,000**	**11,27,500**

Notes:

(1) Deduction u/s 80C in respect of life insurance premium paid by Mr. C

Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium paid during 2016-17	Restricted to % of sum assured	Deduction u/s 80C
14/5/2011	Self	1,00,000	25,000	20%	20,000
11/6/2012	Spouse	1,25,000	15,000	10%	12,500
31/7/2013	Handicapped Son (section 80U disability)	2,00,000	40,000	15%	30,000
			Total		**62,500**

(2) Deduction under section 80CCG in respect of investment made as per the Rajiv Gandhi Equity Savings Scheme

	Particulars	Mr. A	Mr. B
		₹	₹
(i)	Investment in listed equity shares	15,000	62,000

(ii) Investment in units of equity-oriented fund	30,000	-
Total investment	**45,000**	**62,000**
50% of the above	22,500	31,000
Deduction under section 80CCG (restricted to a maximum of ₹25,000)	**22,500**	**25,000**

	Mr. C is not eligible for deduction under section 80CCG since his gross total income exceeds ₹12 lakh.
(3)	**Medical Insurance Premium** (i) Medical insurance premium of ₹ 30,000 paid by account payee cheque by Mr. A is allowed as a deduction under section 80D, subject to a maximum of ₹ 25,000. (ii) Medical insurance premium paid by cash is not allowable as deduction. Hence, Mr. B is not eligible for deduction under section 80D in respect of medical insurance premium of ₹ 15,000 paid in cash. (iii) Mr. C is eligible for deduction of ₹ 20,000 under section 80D in respect of medical insurance premium paid by crossed cheque.
(4)	The maximum amount eligible for deduction under section 80C shall not exceed ₹ 1,50,000. Further, the investment limit in PPF also increased to ₹ 1,50,000. Since Mr. A has no other investment under section 80C during the P.Y. 2016-17, Mr. A would be eligible for deduction of ₹ 1,50,000 in respect of PPF.
(5)	**Deduction in respect of interest and principal repayment of housing loan** Mr. B is eligible for a maximum deduction of ₹ 2,00,000 under section 24 in respect of interest on housing loan taken in respect of a self-occupied property, for which he is claiming benefit of "Nil" annual value. Therefore, ₹ 2,00,000 would represent his loss from house property. The balance ₹ 20,000 can be claimed as deduction under section 80EE, assuming that all the conditions mentioned thereunder also fulfilled. Further, the maximum amount eligible for deduction under section 80C should not exceed ₹ 1,50,000. Since, Mr. B has no other investment under section 80C during the previous year 2016-17, he would be eligible for deduction of ₹ 1,50,000 in respect of principal repayment of housing loan.
(6)	Contribution to National Children's Fund qualifies for 100% deduction under section 80G. Therefore, Mr. A is entitled to 100% deduction of the sum of ₹ 30,000 contributed by him by way of cheque to National Children's Fund.
(7)	Mr. B is eligible for deduction under section 80GGC in respect of donation to a political party made otherwise than by way of cash. However, cash donations to electoral trust do not qualify for deduction under section 80GGC.

***Note** – In case Mr. A sells all the units of equity oriented fund in May 2017, the amount of ₹ 15,000 (i.e., 50% of ₹ 30,000), being deduction allowed to him under section 80CCG in A.Y.2017-18, would be subject to tax in the A.Y.2018-19, since the condition of the minimum fixed lock-in period of one year from the end of P.Y.2016-17 stipulated under the Rajiv Gandhi Equity Scheme, 2013, has been violated in this case. However, in the case of Mr. C, since deduction under section 80CCG was not allowed during the A.Y.2017-18 on account of his gross total income exceeding ₹ 12 lakh, no amount relating to that year can be subject to tax in the A.Y.2018-19, being the year of violation of condition.*

Question 12

What is the deduction allowable in respect of donations for political purposes? How will expenditure on advertisements in souvenirs of political parties be dealt with, in computing income from business?

Answer

As per section 80GGB, any sum contributed by an Indian company in the previous year to any political party or an electoral trust shall be allowed as deduction while computing its total income. For the purpose of this section, the word "contribute" has the meaning assigned to it under section 293A[1] of the Companies Act, 1956, which provides that -

(a) a donation or subscription or payment given by a company to a person for carrying on any activity which is likely to effect public support for a political party shall also be deemed to be contribution for a political purpose;

(b) the expenditure incurred, directly or indirectly, by a company to a political party or an electoral trust on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage shall also be deemed to be a contribution to such political party or a contribution for a political purpose to the person publishing it.

As per section 80GGC, any amount of contribution made to a political party or an electoral trust by an assessee being any person, except local authority and every artificial juridical person wholly or partly funded by the Government shall be allowed as deduction while computing the total income of such person.

For the purposes of sections 80GGB and 80GGC, "political party" means a political party registered under section 29A of the Representation of the People Act, 1951. "Electoral trust" is defined in section 2(22AAA) to mean a trust approved by the Board in accordance with the scheme made in this regard by the Central Government.

As regards expenditure on advertisements in souvenirs of political parties, the meaning of the word "contribute" as discussed above as per section 80GGB makes it clear that such expenditure is deemed to be a contribution to a political party or for a political purpose, in case of assessee company.

[1] Section 182 of the Companies Act, 2013

However, section 37(2B) provides that no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. Therefore, the provisions of section 37(2B) have to be given effect to in computing gross total income. Thereafter, while allowing Chapter- VIA deductions, such expenditure would be allowed under section 80GGB, in case of assessee company.

Question 13

Can an assessee, fulfilling all the prescribed conditions, having total income of ₹ 1,84,000 and paying house-rent @ ₹ 4,800 p.m. in respect of the residential accommodation occupied by him at Mumbai, claim the deduction for the house rent so paid while computing his taxable income?

Answer

An individual, who is not in receipt of house rent allowance and complying with all the conditions as specified in section 80GG, shall be entitled to claim deduction (in respect of rent paid by him for the residential accommodation) of an amount, equal to the least of the following limits, under section 80GG -

		₹	₹
(i)	Actual rent less 10% of total income i.e., ₹ 57,600 minus ₹ 18,400, being 10% of ₹ 1,84,000	39,200	
(ii)	25% of total income i.e., 25% of ₹ 1,84,000	46,000	
(iii)	Amount calculated at ₹ 5,000 p.m.	60,000	
	Deduction allowable (least of the above)		39,200

Note: *It is assumed that ₹ 1,84,000 is the total income before providing deduction under section 80GG.*

Question 14

What is the effect of contribution made by an individual to electoral trust on his taxable income?

Answer

Under section 80GGC, an individual can claim deduction from gross total income in respect of amount of contribution made by him to an electoral trust during the year. However, no deductions shall be allowed in respect of any sum contributed to an electoral trust, by way of cash.

Question 15

Gurudev Engineers Pvt. Ltd. is running an industrial undertaking whose profits are eligible for deduction under section 80-IA of the Income-tax Act, 1961. During the year ended 31.03.2017, the undertaking was engaged in eligible business referred to in section 80-IA(4), which *however, consisted solely of executing works contract awarded by the State Government. Is the assessee eligible to claim deduction under section 80-IA(4) in respect of profits derived from this undertaking?*

Answer

Section 80-IA(1) provides a ten year tax holiday in respect of profits and gains derived by an undertaking or an enterprise from an eligible business i.e., business referred to in sub-section (4).

The *Explanation* to the said section clarifies that the tax holiday under section 80-IA would not be available in relation to a business referred to in sub-section (4) which is in the nature of a works contract awarded by any person (including the Central or State Government) and executed by the undertaking or enterprise referred to in section 80-IA(1).

Therefore, the assessee cannot claim deduction under section 80-IA(4) in respect of the profits derived from this undertaking for the assessment year 2017-18, since, during the year ended 31.3.2017, the undertaking was solely engaged in executing works contract awarded by the State Government.

Question 16

X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill and had a profit of ₹ 100 lakhs in Assessment Year 2016-17. X Ltd. claimed depreciation of ₹ 120 lakhs on windmill against the profit of ₹ 100 lakhs from power generation business which was eligible for deduction under section 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of ₹ 70 lakhs for Assessment Year 2017-18.

The loss of ₹ 20 lakhs, i.e., balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd. The Assessing Officer was of the view that depreciation relating to a business eligible for deduction under section 80-IA cannot be set-off against non-eligible business income. Hence, unabsorbed depreciation should be carried forward to the subsequent year to be set off against eligible business income of the assessee of that year.

Give your views on the correctness of the action of the Assessing Officer.

Answer

In *CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245*, the Karnataka High Court observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of ₹ 120 lacs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is, thereafter, that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Accordingly, X Ltd. is entitled to the benefit of set off of loss of ₹ 20 lacs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of ₹ 70 lacs of Unit Y carrying on non-eligible business. Therefore, the net profit of ₹ 50 lacs would be taxable in the A.Y.2017-18.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y.2018-19, the net profits of Unit N has to be reduced by ₹ 20 lacs for computing the profits eligible for deduction under section 80-IA in that year.

The action of the Assessing Officer in not permitting set-off of loss of eligible business against profits of non-eligible business in this case is, therefore, not correct.

Question 17

CG Ltd. is engaged in the business of conversion of jumbo rolls of films into saleable packets/rolls of standard size. The company seeks your opinion on whether the said process amounts to "manufacture" for the purpose of claim deduction under Section 80-IB?

Answer

The issue in this case is whether conversion of jumbo rolls of films into saleable packets/rolls of standard size would amount to "manufacture" of an article or thing for the purpose of claiming deduction under section 80-IB.

As per section 2(29BA), "manufacture" with all 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.

The conversion of Jumbo rolls of films into rolls of standard size/saleable packets would not amount to "manufacture", as there is no transformation of the original article/thing i.e. jumbo rolls. Rolls of standard size will not have a different character or use. Therefore, the activity of conversion of jumbo rolls of film into rolls of standard size does not amount to "manufacture" for the purpose of deduction under section 80-IB.

Note - *Deduction under section 80-IB is available to any industrial undertaking which, inter-alia, manufactures or produces any article or thing. It is possible to take a view that even though conversion of jumbo rolls of films into rolls of standard size does not fall within the* *meaning of "manufacture", it may fall within the meaning of production, which has a wider connotation than the word "manufacture", hence, be entitled to deduction under section 80-IB.*

Question 18

"Samode Oil Refineries Ltd.", the assessee, has started commercial production of mineral oil from 1st June, 2016 of three wells in a licensed block which was awarded during financial year 2014-15 under the NELP-VIII. The company, for the purpose of claiming deduction under section 80-IB(9), contends that each well is a separate industrial undertaking entitled to deduction. Examine critically in the context of the provisions, the correctness of the contention.

Answer

Sub-section (9) of section 80-IB provides for deduction in respect of profits and gains derived from, *inter alia*, commercial production or refining of mineral oil.

Explanation to sub-section (9) of section 80-IB, put forth a condition that for the purposes of claiming deduction under sub-section (9), all blocks licensed under a single contract, which has been awarded under the New Exploration Licensing Policy VIII announced by the Government of India or has been awarded in pursuance of any law for the time being in force or has been awarded by the Central or a State Government in any other manner, shall be treated as single "undertaking".

In view of the above amendment, the assessee's contention is not correct. Each well in a block cannot be regarded as separate industrial undertaking. The entire block has to be treated as a single industrial undertaking.

Question 19

Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under section 80-IB for your consideration and advice for the assessment year 2017-18:

(i) It operates two separate industrial units. One unit is eligible for deduction under section 80-IB, while the other unit is not eligible for such deduction. If the eligible unit has profit and the other unit has loss, should it claim deduction after setting off the loss of the other unit against profit of the eligible unit?

(ii) Its profit from one unit includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction on these items of income?

Answer

(i) Section 80-IB(13) provides that the provisions contained in section 80-IA(5) shall, so far as may be, apply to the eligible business under section 80-IB. Accordingly, for the purpose of computing the deduction under section 80-IB, the profits and gains of an eligible business shall be computed as if such eligible business was the only source of income of the assessee.

Therefore, Navi Limited should claim deduction under section 80-IB on profit from the eligible unit without setting off loss suffered in the other unit. It may be noted that the aggregate deduction under Chapter VIA, however, cannot exceed the gross total income of the assessee.

(ii) Under section 80-IB, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking referred to in the section, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In *CIT vs. Sterling Foods (1999) 237 ITR 579 (SC)* and *Liberty India vs. CIT (2009) 317 ITR 218 (SC),* it was held that sale of import entitlement and duty drawback cannot be construed as income derived from industrial undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IB.

Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the industrial undertaking, and therefore, the same would be eligible for deduction under section 80-IB. [*Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)]*.

Question 20

A company which is entitled to claim deduction under section 80-IB has received duty drawback under a scheme framed by the Central Government under the Customs Act, 1962. Can such duty drawback form part of the profit of eligible undertaking for the purpose of deduction under section 80-IB?

Answer

Section 80-IB provides for allowing deduction in respect of profits and gains derived from eligible business of the industrial undertaking.

The issue under consideration is whether duty drawback can be regarded as “profits and gains derived from eligible business of the industrial undertaking”.

For a receipt to be treated as having been “derived from” the industrial undertaking, the same should be directly and inextricably connected with the business of the industrial undertaking. The connection should be direct and not remote.

The facts of the case are similar to the facts of the case in *Liberty India v. CIT (2009) 317 ITR 218,* wherein the Supreme Court observed that duty drawback is an incentive which flows from the schemes framed by the Central Government or from the Customs Act, 1962. Profits derived by way of incentives such duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression "profits derived from industrial undertaking" under section 80-IB. They belong to the category of ancillary profits of such undertaking. Hence, duty drawback receipts cannot form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.

Applying the same rationale to the present case, duty drawback would not form part of profit of eligible undertaking for the purpose of deduction under section 80-IB.

Question 21

PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2017:

(i) Interest amounting to ₹ 1,00,000 from its members on loans advanced to them.

(ii) Interest amounting to ₹ 1,50,000 on deposits with other co-operative societies.

(iii) Rent amounting to ₹ 2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof for the assessment year 2017-18.

Answer

Sub-clause (viia) to section 2(24) includes within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of ₹ 1,00,000 received by PQR Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to ₹ 1,50,000 on deposits with other co-operative societies and rent amounting to ₹ 2,00,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said *Explanation* since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of ₹ 1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of ₹ 1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of ₹ 2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

Question 22

The assessee, a Co-operative Society, earned interest income out of the reserve funds, which had been invested with SBI/RBI in compliance with statutory provisions in order to carry on banking business and claimed deduction under Section 80P(2)(a) of Income-tax Act, 1961. The Assessing Officer declined to allow the claim, but restricted its claim to that part of interest income derived from working or circulating capital. Examine the validity of the action of Assessing Officer.

Answer

No deduction under section 80P would be allowed unless the assessee is a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Assuming the society is eligible for deduction by being a primary agricultural credit society or a primary co-operative agricultural and rural development bank, the eligibility for deduction under section 80P vis-a-vis the validity of the action of the Assessing Officer is to be decided. In order to carry on the business of banking, the society had to make investments out of the reserve funds with SBI/ RBI in compliance with statutory provisions and the same was necessary and consequently, such investments are part of the business activities falling within the scope of section 80P(2)(a) of the Income-tax Act, 1961.

There is nothing in the phraseology in section 80P(2)(a)(i) which makes it applicable only to income derived from working or circulating capital. Thus, the action of the Assessing Officer is not correct in law and he should allow the total interest income derived from investments made out of reserve funds under section 80P(2)(a). [*CIT vs. Karnataka State Co-operative Apex Bank (2001) 251 ITR 194 (SC)]*.

12

Inter-Relationship between Accounting and Taxation

Question 1

How would non-consideration of prudence in selection and application of accounting policies impact the computation of total income under the Income-tax Act, 1961? Give examples of non-consideration of prudence in the Income Computation and Disclosure Standards (ICDSs).

Answer

The concept of prudence requires that provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information. Non-consideration of prudence in selection and application of accounting policies may have the impact of earlier recognition of income and gains or later recognition of expenses or losses for tax computation.

Examples of non-consideration of prudence in the ICDSs:

(i) The requirement in ICDS VII on Government Grants that recognition of a Government grant shall not be postponed beyond the date of actual receipt, even if conditions attached to the grant are not fulfilled.

(ii) Non-recognition of expected losses on construction contracts and contract costs, recovery of which is not probable, as an expense immediately, in ICDS III on Construction Contracts.

(iii) Non-recognition of provision for loss on onerous contracts.

Question 2

How is inventory on the date of dissolution of a firm to be valued, where the firm's business is to be continued by one of its partners, in a case where the dissolution has taken place on or after 1.4.2016? What was the manner in which such inventory would have been valued had the dissolution taken place on 31.3.2016?

Answer

Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee. Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, **income computation and disclosure standards** to be followed by any class of assessees or in respect of any class of income. Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by **all assesses (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB), following the mercantile system of accounting,** for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources", from A.Y. 2017-18.

In case of dissolution of a partnership firm or association of persons or body of individuals, Paragraph 24 of ICDS II on Valuation of Inventories requires the inventory on the date of dissolution to be valued at the net realisable value, notwithstanding whether business is discontinued or not.

This requirement in ICDS II is in deviation from the Supreme Court ruling in *Shakti Trading Co. vs. CIT (2001) 250 ITR 871,* where it was held that if the firm is dissolved due to death of a partner and the surviving partners reconstitute the firm and continue the business as before, the firm is entitled to adopt cost or market price, whichever is lower.

Therefore, if the firm was dissolved on 31.3.2016, the valuation of inventory would be governed by the Supreme Court ruling in Shakti Trading Company's case. However, if the dissolution takes place on or after 1.4.2016, it would be governed by ICDS II and the inventory has to be valued at the net realizable value, notwithstanding whether business is discontinued or not.

Question 3

What are the main differences between the treatment given in AS 7 and ICDS III relating to construction contracts?

Answer

	Point of difference	AS 7 *vis-à-vis* ICDS III
(1)	Point in time of recognition of expected loss on construction contracts	AS 7 permits recognition of expected loss on construction contract as well as contract costs, recovery of which is not probable, as an expense immediately. It also permits recognition of expected loss immediately as an expense, when it is probable that total contract costs will exceed total contract revenue. The absence of specific requirement in ICDS III to recognize such expected losses on construction contracts immediately as expense represents a

		significant deviation from AS 7 as well as judicial rulings permitting immediate recognition of such losses as long as the same are in accordance with the accounting standard or justified by the principle of prudence or by the nature and circumstances of the contract. By implication, such losses are also to be recognized on Percentage of Completion Method as per ICDS III. Consequently, recognition of losses for tax purposes is postponed.
(2)	Treatment of penalties arising from delays caused by the contractor in completion of the contract	Paragraph 11 of AS 7 permits decrease in contract revenue as a result of penalties arising from delays caused by the contractor in the completion of the contract. However, ICDS III does not permit such reduction in contract revenue. Non-recognition of decrease in contract revenue as a result of such penalties would have the effect of inflating the taxable income and consequent tax liability.
(3)	Point in time of recognition of retention money	ICDS III requires retention money to be treated as part of contract revenue and recognized on percentage of completion method. As per paragraph 10 of ICDS III, "Contract Revenue" shall comprise of the initial amount of revenue agreed in the contract, including retentions. However, as per paragraph 10 of AS 7, contract revenue should comprise the initial amount of revenue agreed in the contract. While there is a specific requirement in paragraph 10 of ICDS III to include retentions, there is no such requirement in paragraph 10 of AS 7.

Question 4

"The conditions for recognition of provisions and contingent assets are more stringent in ICDS X as compared to AS 29" - Elucidate.

Answer

Condition for recognition of Provision

AS 29 requires recognition of a provision when it is **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation.

ICDS X requires recognition of a provision only when it **is reasonably certain** that an outflow of resources embodying economic benefits will be required to settle the obligation.

The requirement of "reasonable certainty" in ICDS X to recognize a provision is more stringent as compared to the requirement of "probability" in AS 29. This may have the

effect of postponing the recognition of provision for tax purposes and consequently, result in earlier payment of taxes.

Condition for recognition of Contingent Asset

Both AS 29 and ICDS X provide that a contingent asset should not be recognized. Further, both AS 29 and ICDS X require contingent assets to be assessed continually.

Thereafter, recognition of contingent assets and related income is required in –

AS 29, if inflow of economic benefits is **"virtually certain";**

ICDS X, if inflow of economic benefits is **"reasonably certain".**

The requirement of "reasonable certainty" in ICDS X to recognize a contingent asset and the related income is more stringent as compared to the requirement of "virtual certainty" in AS 29. This deviation between AS 29 and ICDS X may have the effect of advancing recognition of income for tax purposes and consequently, result in earlier payment of taxes.

Exercise

1. *Distinguish between "Permanent difference" and "Timing difference", with the help of examples.*
2. *When does a deferred tax asset and deferred tax liability arise? Explain giving examples.*
3. *What are the criteria for recognizing a deferred tax asset?*
4. *What are the accounting entries to be passed for recognition and reversal of a deferred tax asset and deferred tax liability?*

Annexure

Income Computation and Disclosure Standards

Section 145 of the Income-tax Act, 1961 provides for the method of accounting. Section 145(1) requires income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" to be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee, subject to the provisions of section 145(2). Under section 145(2), the Central Government is empowered to notify in the Official Gazette from time to time, **income computation and disclosure standards (ICDSs)** to be followed by any class of assessees or in respect of any class of income.

Accordingly, the Central Government had, vide Notification No.S.O.892(E) dated 31.3.2015, in exercise of the powers conferred by section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assessees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources". This notification was to come into force with effect from 1st April, 2015, to be applicable from A.Y. 2016-17.

However, the Central Government has, *vide* Notification No.S.O.3078(E) dated 29.9.2016, rescinded Notification No.S.O.892(E) dated 31.3.2015. Simultaneously, *vide* Notification No.S.O.3079(E) dated 29.9.2016, the Central Government has notified ten new ICDSs to be applicable from A.Y.2017-18. The newly notified ICDSs have to be followed by all assessees (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB) following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources", from A.Y.2017-18.

[A.Y.2017-18 is the assessment year relevant for May, 2017 and November, 2017 examinations. Therefore, the ICDSs notified on 29.9.2016 to be applicable from A.Y.2017-18 are relevant for students appearing in May, 2017 and November, 2017 examinations. The text of the ICDSs notified on 29.9.2016 is given as Annexure at the end of this Practice Manual. The significant changes in the ICDSs notified on 29.9.2016 vis-à-vis ICDSs initially notified on 31.3.2015 (since rescinded) have been briefed hereunder].

Significant changes made in the ICDSs notified on 29.9.2016 (newly notified ICDSs) *vis-à-vis* ICDSs initially notified on 31.3.2015 (since rescinded)

There are no changes in ICDS I: Accounting Policies, ICDS VII: Government Grants and ICDS X : Provisions, Contingent Liabilities and Contingent Assets. The significant changes in the other ICDSs are briefed hereunder. The transitional provisions, however, have been revised in all ICDSs in line with the new implementation date.

ICDS II: Valuation of Inventories

Recognition of standard cost method for measuring cost of inventories: Whereas AS 2 permits standard cost method as one of the techniques for the measurement of the cost of inventories, for convenience if the results approximate the actual cost, there was no enabling clause or para in the initially notified ICDS II permitting adoption of standard cost as a technique for measurement of the cost of inventories.

The newly notified ICDS II permits techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, to be used for convenience if the results approximate the actual cost. New ICDS II goes on to explain that standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilization. They are regularly reviewed and, if necessary, revised in the light of the current conditions.

Further, where standard costing has been used as a measurement of cost, details of such inventories and a confirmation of the fact that standard cost approximates the actual cost have to be disclosed.

ICDS III: Construction contracts

Recognition of contract revenue and contract costs, associated with construction contracts in progress as on 31.3.2016, on the basis of method regularly followed: The newly notified ICDS III permits contract revenue and contract costs associated with the construction contract, which commenced on or before 31.3.2016 but not completed by the said date, to be recognised based on the method regularly followed by the person prior to the previous year 2016-17. As per the initially notified ICDSs, such contract revenue and costs in respect of construction contracts in progress as on 31.3.2015 had to be recognized only in accordance with the provisions of the standard.

ICDS IV: Revenue Recognition

Revenue recognition in case of rendering of services: Revenue from service transactions is required to be recognized on the basis of percentage completion method as per ICDS IV. The newly notified ICDS IV, however, permits revenue to be recognised on a straight line basis over a specific period of time, when services are provided by an indeterminate number of acts over such period.

As per the initially notified ICDS IV, "reasonable certainty for ultimate collection" was not a criterion for recognition of revenue from rendering of services. However, the newly notified ICDS IV permits revenue from service contracts with duration of not more than 90 days to be recognised when the rendering of services under that contract is completed or substantially completed.

Point in time when interest would be treated as income chargeable to tax: As per ICDS IV, interest shall accrue on the time basis determined by the amount outstanding and the rate applicable. However, the newly notified ICDS IV goes on to provide that interest on refund of any tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received.

ICDS V: Tangible Fixed Assets

Requirement to mention details of jointly owned tangible fixed assets separately in the tangible fixed assets register dispensed with: The initially notified ICDS V contained a requirement to indicate separately in the tangible fixed assets register, the details of jointly owned tangible fixed assets. However, the requirement to mention these details separately has been dispensed with in the newly notified ICDS V.

ICDS VI: Effects of changes in foreign exchange rates

Requirement of classification of foreign operations as integral or non-integral dispensed with: As per the initially notified ICDS VI, foreign operations had to be classified as either "integral foreign operations" or "non-integral foreign operations". There is no requirement for such classification in the newly notified ICDS VI.

Conversion at last day of the previous year - Non-monetary item being inventory carried at NRV denominated in foreign currency: As per the newly notified ICDS VI, at last day of each previous year, non-monetary item being inventory which is carried at net realisable value denominated in a foreign currency shall be reported using the exchange rate that existed when such value was determined.

ICDS VIII: Securities

In the newly notified ICDS VIII, there are two parts. Part A deals with securities held as stock-in-trade. Part B deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 or the Companies Act, 2013. Part B has been inserted in the newly notified ICDS VIII.

Scope of definition of "securities" in Part A expanded: The definition of "securities" in Part A of the newly notified ICDS VIII has been expanded to specifically include share of a company in which public are not substantially interested.

Use of "Weighted Average Cost" formula permitted for subsequent measurement of securities held as stock-in-trade (other than unlisted or unquoted securities) referred to in Part A: As per the newly notified ICDS VIII, in a case where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method or weighted average cost formula. In the initially notified ICDS VIII, only FIFO method was permitted to be used for determining the cost of such security.

Securities referred to in Part B to be classified, recognized and measured in accordance with the extant guidelines issued by RBI: Securities referred to in Part B to be classified, recognised and measured in accordance with the extant guidelines issued by the RBI in this regard. Any claim for deduction in excess of the said guidelines will not be taken into account. To this extent, the provisions of ICDS VI on the effect of changes in foreign exchange rates relating to forward exchange contracts would not apply.

ICDS IX: Borrowing Costs

Specification of minimum period for treating an asset as a qualifying asset for the purpose of computing the amount of borrowing costs to be capitalised: The initially notified ICDS IX did not provide any minimum period for treating an asset as a qualifying asset (except in the case of inventories). This concern has been partially addressed in the newly notified ICDS IX. *Explanation* to paragraph 6 clarifies that, for the purpose of computing the amount of borrowing costs to be capitalized, in a case where the funds are not borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, a qualifying asset would be such asset that necessarily require a period of 12 months or more for its acquisition, construction or production.

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Assessment of Various Entities

Question 1

Are the provisions of AMT are applicable to all assessees other than the companies? Discuss.

Answer

The provisions of AMT are applicable to all persons claiming profit linked deductions (i.e., deductions under any section (other than section 80P) in Chapter VIA under the heading "C – Deductions in respect of certain incomes" or section 10AA or under section 35AD).

The provisions of AMT would be applicable to an individual, HUF, AOP, BOI, whether incorporated or not, or artificial juridical person.

Also, it is applicable only if the adjusted total income of such person exceeds ₹ 20 lakh.

Note – *The statement can be viewed as correct since AMT applies to all assessees, other than companies. It can be viewed as incorrect since AMT is not applicable to all assessees* ***per se****, but only to those assessees claiming profit linked deductions*.

<u>Assessment of Individuals</u>

Question 2

Peeyush, an NRI, returned to India on 12th June, 2016 for permanently residing in India after a stay of about 20 years in U.K. In the past 20 years, his stay in India was 320 days only. He provides the sources of his various incomes and seeks your opinion to know about his liability to income tax thereon in India for the assessment year 2017-18:

(i) Income by way of rent from flat in London which was deposited in a bank there. The flat was let out after his return to India i.e. since July, 2016.

(ii) Dividends from shares of 3 German Companies which are credited to his bank account in London. He proposes to keep the dividend income in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, aged 19 years and 12 years. Both are staying in London and did not return to India with him. Each of them have income of ₹ 75,000 in U.K. (not received in India) and ₹ 20,000 in India.

(iv) During the preceding financial year when he was a non-resident, he sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were

repatriated. The profit in terms of British Pound Sterling on sale of these shares was 175% of the cost, which in terms of Indian Rupee it was ₹ 50,000.

Answer

Peeyush returned to India on 12th June 2016 for permanently residing in India after staying in UK for 20 years. During the P.Y. 2016-17, he stays in India for 294 days. Since he has stayed in India for a period of 182 days or more during the previous year 2016-17, he would be a resident in India for the A.Y.2017-18. However, he would be a resident but not ordinarily resident, since his stay in India during the seven preceding previous years is less than 730 days. The residential status of Peeyush for A.Y.2017-18 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing a deduction of ₹ 1,500 per child under section 10(32).

Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹ 1,500. Therefore, ₹ 18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the total income of Peeyush.

Since, his other son is a major son his income is not includible in the total income of Peeyush.

(iv). Repatriation of sale proceeds of 1000 shares sold in the preceding year, when Peeyush was a non-resident, is not taxable in the A.Y.2017-18 since it is not the income of the P.Y.2016-17.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2017-18. Since his total income (i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2017-18.

Question 3

During the financial year 2016-17, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won the prize money of ₹ 15 lacs. He *contributed articles on the tournament in a local newspaper for which he was paid ₹ 1 Lac. He was also paid ₹ 5,00,000 by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur ₹ 3,00,000 towards his travel costs to India. He was a non-resident for tax purposes in India.*

What would be his tax liability in India for A.Y. 2017-18? Is he required to file his return of income?

Answer

Under section 115BBA, all the three items of receipts in India viz. prize money of ₹ 15 lakhs, amount received from newspaper of Rs.1 lakh and amount received towards TV advertisement of ₹ 5 lakhs - are chargeable to tax. No expenditure is allowable against such receipts. The rate of tax chargeable under section 115BBA is 20 per cent, plus education cess @2% and secondary and higher education cess @1%. The total tax liability works out to ₹ 4,32,600 being 20.6% of ₹ 21 Lacs. Thus, Nadal will be liable to tax on the income earned in India.

He is not required to file his return of income if (a) his total income during the previous year consists only of income arising under section 115BBA **and** (b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

Question 4

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2017. He received ₹ 5 lakhs for participation in matches in India. He also received ₹ 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received ₹ 10,000. When he stayed in India, he also won a prize of ₹ 10,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2017-18.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for Assessment Year 2017-18?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

Answer

(i) Computation of tax liability of Smith for the A.Y.2017-18

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	
Income taxable under section 115BB		
Income from horse races	10,000	
Total income	**6,20,000**	

Tax@ 20% under section 115BBA on ₹ 6,10,000		1,22,000
Tax@ 30% under section 115BB on income of ₹ 10,000 from horse races		3,000
		1,25,000
Add: Education cess@2% and Secondary and higher education cess@1%		3,750
Total tax liability of Smith for the A.Y.2017-18		**128,750**

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., ₹ 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e., ₹ 10,000, in this case) is subject to tax deduction at source@30% under section 194BB.

Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by education cess@2% and secondary and higher education cess@1%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2017-18.

(iv) The Calcutta High Court in *Indcom v. CIT (TDS) (2011) 335 ITR 485* has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

Particulars		₹
Tax@30% under section 115BB on winnings of ₹ 10,000 from horse races		3,000
Tax on ₹ 6,10,000 at the rates in force		
Upto ₹ 2,50,000	Nil	
2,50,000 – 5,00,000 @ 10%	25,000	
5,00,000 – 6,10,000 @ 20%	22,000	47,000
		50,000
Add: Education cess@2% and secondary and higher education cess@1%		1,500
		51,500

Question 5

Ajay, a non-resident Indian, has the following sources of income in India during the previous year 2016-17:

	Particulars	*₹*	*₹*
(i)	*Income from house property located in India (computed)*		*1,80,000*
(ii)	*Dividend from Indian Companies*		*75,000*
(iii)	*Interest on debentures of Indian company (Subscribed in convertible foreign exchange)*	*1,00,000*	
	Less: Interest on loan taken for purchase of debentures	*20,000*	*80,000*
(iv)	*Long-term capital gains on sale of debentures subscribed in US $:*		
	Cost in 2004-05	*4,00,000*	
	Sale in 2016-17	*6,00,000*	
		2,00,000	
	Less: Commission to brokers	*6,000*	*1,94,000*
	Cost Inflation Index: F.Y. 2004-05 - 480; F.Y.2016-17 – 1125.		

Compute the tax payable by Ajay for Assessment Year 2017-18, if he opts for the provisions of Chapter XII-A of the Income-tax Act, 1961.

Answer

Computation of tax liability of Mr. Ajay for the A.Y. 2017-18 as per Chapter XII-A

Particulars	₹	₹
Tax on long term capital gain (₹ 1,94,000 × 10%) **[See Notes 1 & 2]**	19,400	
Tax on interest on debentures being investment income (₹ 1,00,000 × 20%) **[See Notes 1 & 3]**	20,000	
Tax on balance income of ₹ 1,80,000	Nil	39,400
Add: Education cess @ 2%		788
Add: Secondary and higher education cess @ 1%		394
Total tax liability		**40,582**
Total tax liability (rounded off)		**40,580**

Notes:

(1) Computation of total income of Mr. Ajay for the A.Y. 2017-18 as per provisions of Chapter XII-A

Particulars	₹	₹
Income from house property (computed)		1,80,000
Capital Gains on sale of debentures		
Sale consideration	6,00,000	

Less: Commission to brokers	6,000	
Net sale consideration	5,94,000	
Cost of acquisition **(Refer Note 2)**	4,00,000	
Long term capital gain		1,94,000
Dividend income received from Indian companies [exempt under section 10(34)]		Nil
Interest on debentures of Indian company **(Refer Note 3)**		1,00,000
Total Income		**4,74,000**

(2) As per section 115D, the indexation benefit would not be available for calculating cost of acquisition for computing long term capital gains under Chapter XII-A.

(3) No expenditure is allowed to be deducted from the interest on debentures being the investment income as per the provisions of section 115D. Therefore, interest on loan taken for purchase of debentures is not deductible.

(4) As per the provisions of section 115E, the tax rate applicable on investment income is 20% and on the long term capital gain the tax rate applicable shall be 10%. The balance income shall be chargeable to tax as per the normal tax rates.

(5) It has been assumed that the debentures referred to in the question are issued by an Indian company which is not a private company and are hence, specified assets. Since the specified assets have been subscribed in convertible foreign exchange, they are foreign exchange assets.

Note *- If a non-resident purchases shares in, or debentures of, an Indian company by utilising foreign currency, capital gain shall be calculated under first proviso to section 48 in the same foreign currency which was initially utilised in purchase of shares and debentures. Capital gains so computed in foreign currency shall be reconverted into Indian currency. Since the telegraphic transfer buying rates and telegraphic transfer selling rates of US $ on the date of acquisition, date of sale and 31st March, 2017 are not given in the question, effect has not been given to the first proviso to section 48 in the above solution.*

Question 6

Who can be treated as an agent of a non-resident foreign collaborator for the purpose of proceedings and/or any other matters under the Income-tax Act, 1961?

Answer

Section 2(7) defining the term 'assessee', includes within its scope, a representative assessee as well. The Assessing Officer is statutorily empowered to issue notice under section 163 to any person to deem him as the agent of the non-resident including foreign collaborator.

The term 'agent' in relation to a non-resident includes:-

(i) any person in India who is employed by or on behalf of the non-resident; or

(ii) any person in India who has any business connection with the non-resident; or

(iii) any person in India from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or

(iv) any person in India who is the trustee of the non-resident; or

(v) any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India.

However, a broker in India who in respect of any transaction does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker will not be deemed to be an agent under section 163 in respect of such transactions, provided both the following conditions are fulfilled:

(a) the transactions must be carried on in the ordinary course of business through the first mentioned broker; and

(b) the non-resident broker must be one who carries on such transactions in the ordinary course of his business and not as a principal.

It may be noted that no person shall be treated as the agent of a non-resident unless an opportunity of being heard is given to him by the Assessing Officer.

Question 7

Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2017 as under:

(a) Net Profit of ₹ 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:

(i) Personal travelling expenses of ₹ 12,750.

(ii) Purchase of furniture items for shop on 13.6.2016 of ₹ 25,000 but charged in shop expenses.

(b) He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self use and first floor was let out on rent for ₹ 8,500 p.m. from April, 2016. The municipal tax paid for the whole house was of ₹ 2,500 and interest paid on housing loan for the construction was ₹ 52,000. Both the floors of the house are identical.

(c) He deposited insurance premium on the life of self of ₹ 12,500, wife ₹ 13,500, son and daughter of ₹ 28,000, repaid housing loan of ₹ 50,000 and paid ₹ 35,000 by credit card for health insurance of himself and his family.

Compute taxable income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2017-18.

Answer

Computation of total income of Mr. Harsh for the A.Y.2017-18

Particulars	₹	₹
Income from house property		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [₹ 52,000 × 50%]	26,000	(26,000)
Let-out portion (50%)		
Income of let out portion being rent of ₹ 8,500 p.m. received for 12 months **(Rent received has been taken as the GAV in the absence of other information).**		
Gross Annual Value under section 23(1) (₹ 8,500 × 12)	1,02,000	
Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of ₹ 2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
***Less:* Deduction under section 24**		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	44,525
		18,525
Profits and gains of business or profession		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @ 10% on ₹ 25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: **Deduction under Chapter VI-A**		
Under section 80C		
- Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	

- Housing loan repaid	50,000	
	1,04,000	
Maximum allowable upto ₹ 1.50 lakh (section 80CCE)	1,04,000	
Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of ₹ 35,000 [maximum deductible is ₹ 30,000 where it covers a resident senior citizen]	30,000	1,34,000
Total Income		**2,85,275**
Total Income (rounded off)		2,85,280
Tax on total income of ₹ 2,85,280		Nil
(The basic exemption limit for senior citizen is ₹ 3,00,000 for A.Y.2017-18)		

Assessment of HUFs

Question 8

Mr. Ram (age 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (age 28) and Minor D (age 16). The HUF is assessed to income tax and has business income from the year 2010-11 onwards. The business income of HUF for the year ended 31.3.2017 is ₹ 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is ₹ 6,10,000 (computed).

You are requested to answer the following treating each of them as independent situations:

(i) Mr. C gave cash gift of ₹ 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

(ii) The HUF has one house property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?

(iii) Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed?

(iv) A car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 1-10-2016. How would this income be taxed?

Answer

(i) Cash gift of ₹ 1 lakh by Mr. C, Ram's major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(vii). Since Mr. C, being Mr. Ram's son, is a member of Ram's HUF, he is a relative of the HUF. Hence the total income of HUF would be ₹ 5 lakhs, being the business income computed.

Note *- Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the*

Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iii) Income of ₹ 70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A).

(iv) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.

Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of ₹ 60,000 (₹ 10,000 × 6 months) less depreciation] would be deemed as the income of Mr. Ram.

Question 9

Krishan Kanhaiya HUF, running Kanha Departmental Stores consists of Karta, his wife, two sons and daughter. Both the sons who are having professional/technical qualifications as a Chartered Accountant and as an Automobile Engineer started in partnership, a garage for the repair of motor cars, with a clear understanding that the technical side of the business be looked after by the Engineer while the general administration and finance part be taken care of by the Chartered Accountant. They took an interest-free loan of ₹ 5,00,000 from the HUF for starting the venture. The business of garage resulted in a net profit of ₹ 15,00,000 for the year ended 31.03.2017. The Assessing Officer proposes to assess the income from the business of motor garage in the hands of HUF. What do you say about the validity of the proposition of the Assessing Officer?

Answer

The Delhi High Court, in *CIT v. Charan Dass Khanna & Sons (1980) 123 ITR 194,* observed that if the investment made by the HUF in the business started by the coparceners plays a minor role and it is primarily the personal efforts, specialized skill and enterprise of the individual coparceners which resulted in setting up of a new business and earning of profits, then it may not essentially be said that the income belongs to the HUF.

In this case, the profits were earned primarily because of the specialized skills acquired by both the partners in their respective fields and used in the business of motor garage. The initial capital taken from the HUF as interest free loan, of course, has its role but it is nevertheless a minor one. Therefore, the income from the business set up by the brothers is assessable in their individual hands and not as the income of the family.

The Supreme Court has also supported this view in the case of *K.S. Subbiah Pillai v. CIT (1999) 237 ITR 11.* In that case, it was held that where the remuneration and commission earned by the Karta were due to the personal qualifications and exertions and not on account of the investment of the family funds, such income cannot be treated as income of the HUF.

The proposition of the Assessing Officer to tax the profits of the business of motor garage earned by the two sons in the hands of the HUF is not tenable.

Question 10

Raj & Family is a HUF in which Mrs. Raj (a member) has impressed upon a house property owned by her for the common hotchpot of the family. Examine whether the income from the asset would be chargeable to tax in the hands of Mrs. Raj or in the hands of the HUF.

Answer

Explanation to section 56(2) says that the term 'relative' in the case of HUF includes any member thereof. Thus the act of impressing a separate property into the common hotchpot of the HUF will not have any tax implication both in the hands of the donor-member and donee-HUF.

The act of impressing the property into the common hotchpot of the HUF is tax neutral, for the purpose of taxing the income arising from the property reference must be made to section 64(2) of the Act. When an individual being a member of HUF has impressed such individual property into the hotchpot of the HUF then any income arising from the property to the family shall be chargeable to tax in the hands of the individual and not in the hands of the family.

Therefore, income from the asset impressed by Mrs. Raj would be taxed in her hands though it has been converted into HUF property by her. It may be noted that section 64(2) covers even mixing of property by members of the HUF and is not confined to coparceners mixing their separate property into the hotchpot of the HUF.

Note *– With effect from 9.9.2005, due to the amendment of the Hindu Succession Act, the daughter of a coparcener shall, by birth, become a coparcener in her own right in the same manner as a son. However, this amendment would not affect the answer, since in this case, Mrs. Raj is a member of the HUF and it is covered by section 64(2) of the Act.*

Assessment of Firms/LLPs

Question 11

PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2012-13 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2015-16, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to ₹ 75 *lakhs (including cost of land ₹ 10 lakhs). The warehouse became operational with effect from 1st April, 2016 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date.*

Relevant details for the financial year 2016-17 are as follows:

Particulars	₹
Profit of unit located in SEZ	*40,00,000*
Export sales of above unit	*80,00,000*
Domestic sales of above unit	*20,00,000*
Profit from operation of warehousing facility (before considering deduction under Section 35AD).	*1,05,00,000*

Compute income tax (including AMT under Section 115JC) payable by PQR LLP for Assessment Year 2017-18.

Answer

Computation of total income and tax liability of PQR LLP for A.Y.2017-18

(under the regular provisions of the Income-tax Act, 1961)

Particulars	₹	₹
Profits and gains of business or profession		
Unit in SEZ	40,00,000	
Less: Deduction under section 10AA **[See Note (1) below]**	32,00,000	
Business income of SEZ unit chargeable to tax		8,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD **[See Note (2) below]**	97,50,000	
Business income of warehousing facility chargeable to tax		7,50,000
Total Income		**15,50,000**
Computation of tax liability (under the normal/regular provisions)		
Tax@30% on ₹15,50,000		4,65,000
Add: Education cess@2% and SHEC@1%		13,950
Total tax liability		**4,78,950**

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax

Particulars	₹	₹
Total Income (as computed above)		**15,50,000**
Add: Deduction under section 10AA		32,00,000
		47,50,000
Add: Deduction under section 35AD	97,50,000	
Less: Depreciation under section 32		

On building @10% of ₹ 65 lakhs[1]	6,50,000	91,00,000
Adjusted Total Income		**1,38,50,000**
Alternate Minimum Tax@18.5%		25,62,250
Add: Surcharge@12% (since adjusted total income > ₹1 crore)		3,07,470
		28,69,720
Add: Education cess@2% and SHEC@1%		86,092
		29,55,812
Tax liability under section 115JC (rounded off)		**29,55,810**

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @ 18.5% thereof *plus* surcharge@12% and cess@3%. Therefore, the tax liability is ₹ 29,55,810.

AMT Credit to be carried forward under section 115JEE	**₹**
Tax liability under section 115JC	29,55,810
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	4,78,950
	24,76,860

Notes:

(1) **Deduction under section 10AA in respect of Unit in SEZ =**

$$\text{Profit of the Unit in SEZ} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}}$$

$$₹\ 40,00,000 \times \frac{₹\ 80,00,000}{₹\ 1,00,00,000} = ₹\ 32,00,000$$

(2) Weighted deduction@150% of the capital expenditure is available under section 35AD for A.Y.2017-18 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012[2].

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction (weighted deduction, in this case) during the previous year in which he commences operations of his specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

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[1] Assuming the capital expenditure of ₹ 65 lakhs is incurred entirely on buildings

[2] It may be noted that weighted deduction is not available from the assessment year 2018-19 onwards in respect of any of the specified businesses as sub-section (1A) to section 35AD stands omitted w.e.f. 01.04.2018.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ₹ 65 lakhs (i.e., ₹ 75 lakhs – ₹ 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y.2015-16 and capitalized in the books of account on 1.4.2016, being the date when the warehouse became operational, ₹ 97,50,000, being 150% of ₹ 65 lakhs would qualify for deduction under section 35AD.

Question 12

MNO Corporation LLP, is carrying on two businesses viz. Textile manufacture and Operation of cold chain facility. Separate books of account are maintained for the said businesses.

It gives you the following information for the year ended 31st March, 2017:

Net profit as per Profit & Loss Account:

From Textile Manufacture	*₹ 10,25,000*
From Operation of cold chain facility	*₹ 20,50,000*

The following items are debited to Profit & Loss Account:

(i) Interest on capital payable to partners @ 15% on total capital of ₹ 100 lakhs invested in the business of operation of cold chain facility.

(ii) Working partner salary ₹ 36 lakhs (i.e., ₹ 1 lakh each per month for 3 partners).

(iii) Depreciation on textile factory building ₹ 5 lakhs.

(iv) Depreciation on Plant & Machineries of textile business ₹ 35 lakhs.

(v) Keyman insurance policy premium paid ₹ 1,55,000.

Other Information:

Eligible depreciation under section 32 for the previous year 2016-17 are-

(i) On plant & machineries of textile business ₹ 27 lakhs.

(ii) On factory building relating to textile business ₹ 4 lakhs.

The assessee set up and was operating a cold chain facility since 1st April, 2015. It incurred capital expenditure towards construction of cold chain facility during the period from 1st June, 2013 to 31st March, 2015 as under:

Cost of land (acquired on 1st June, 2013) ₹ 30 lakhs.

Cost of construction of building and machineries installed till 31st March, 2015 ₹ 50 lakhs.

The income of the firm for the previous year 2015-16 (Assessment Year 2016-17) is given below:

Income from Textile manufacture ₹ 12 lakhs.

Income from cold chain facility ₹ 60 lakhs (before deduction under section 35AD)

***Extra information**: The firm originally had 4 equal partners and one partner retired on 31-3-2016. The partnership agreement authorizes payment of salary and interest on capital which are debited to Profit & Loss Account. The deed authorizes payment of interest on capital contributed towards textile business only. Separate identity is maintained between the businesses without inter-mixing or interlacing of funds.*

You are requested to compute the total income of the firm for the A.Y.2017-18.

***Note:** Ignore Alternate Minimum Tax (AMT) under section 115 JC.*

Answer

Computation of total income MNO Corporation LLP for the A.Y.2017-18

Particulars			₹	
Profits and Gains from Business or Profession				
Net profit as per profit and loss account (₹ 10,25,000 + ₹ 20,50,000)				30,75,000
Add: Items debited to profit & loss account but not allowable as deduction/to be considered separately				
(1)	Interest on capital payable to partners in excess of 12% disallowed under section 40(b) (₹ 100 lakhs × 3%)		3,00,000	
(2)	Working Partner's salary (to be considered separately)		36,00,000	
(3)	Depreciation as per books of account (₹ 5 lakhs + ₹ 35 lakhs) relating to textile business		40,00,000	
(4)	Keyman insurance premium paid (allowable as deduction, since it is incurred wholly and exclusively for the purpose of business – *Circular No.762 dated 18.2.1998*)		-	
				79,00,000
				1,09,75,000
Less: Depreciation under section 32 of the Income-tax Act, 1961 (relating to textile business) [₹ 27 lakhs + ₹ 4 lakhs]				31,00,000
Book Profit				**78,75,000**
Less: Remuneration to working partners [Subject to limits specified in section 40(b)]				
	On first ₹ 3,00,000 of book profit	90% of book profit or ₹1,50,000, whichever is higher	2,70,000	
	On the balance of book profit ₹ 75,75,000 [₹ 78,75,000 – ₹ 3,00,000]	60% of balance book profit	45,45,000	
			48,15,000	
Restricted to actual remuneration paid				36,00,000
Income under the head Profits and gains of business or profession				**42,75,000**

Income from textile manufacturing business **[See Notes 5 & 6]**		19,25,000
Income from specified business of operating a cold chain facility [₹ 42,75,000 - ₹ 19,25,000]	23,50,000	
Less: Set-off of brought forward loss of specified business under section 73A **[See Notes 1 to 4 below]**	11,25,000	12,25,000
Total Income		**31,50,000**

Notes:

(1) **Computation of loss of specified business of setting up and operating a cold chain facility for P.Y.2015-16 relevant to Assessment Year 2016-17**

Particulars	₹
Income from cold chain facility [before deduction under section 35AD]	60,00,000
Less: Deduction under section 35AD [150% of ₹ 50,00,000] **[See Notes 2 & 3]**	75,00,000
Loss of specified business for P.Y.2015-16	15,00,000
Loss to be carried forward as per section 73A read with section 78 [₹15,00,000 × ¾] to be set-off against profits of any specified business of the subsequent years **[See Note 4 below]**	₹ 11,25,000

(2) The specified business of setting up and operating a cold chain facility would be eligible for weighted deduction@150% of the capital expenditure, if the operations are commenced on or after 1.4.2012 **[Section 35AD(1A)]**. In this case, since the operations have commenced on 1.4.2015, the specified business qualifies for weighted deduction @ 150% of capital expenditure.

(3) Expenditure of capital nature would, however, not include any expenditure incurred on acquisition of land **[Section 35AD(8)(f)]**. Therefore, in this case, only cost of ₹ 50 lakhs on construction of building and machinery installed would qualify for deduction under section 35AD, assuming that such expenditure has been capitalized in the books of account as on 1.4.2015 (being the date of commencement of operations), since the same was incurred prior to commencement of operations **[Proviso to section 35AD(1)]**.

(4) Section 78(1) does not permit carry forward of losses pertaining to the share of a retired or deceased partner. Therefore, in this case, since one of the four partners have retired on 31.3.2016, his share of loss (₹ 3,75,000, being ¼th of ₹15 lakh) for the previous year 2015-16 (A.Y.2016-17) cannot be carried forward to the previous year 2016-17 (A.Y.2017-18).

(5) **Computation of profit from textile manufacturing business**

Particulars	₹
Profits and Gains from Business or Profession	
Net profit as per profit and loss account	10,25,000

Add: Depreciation as per books of account (₹ 5 lakhs + ₹ 35 lakhs) relating to textile business	40,00,000
	50,25,000
Less: Depreciation under section 32 of the Income-tax Act, 1961 (relating to textile business)	31,00,000
	19,25,000

(6) Loss of specified business can be carried forward indefinitely for set-off only against profits of any specified business. Therefore, it becomes necessary to segregate the income of ₹ 42.75 lakhs computed under the head "Profits and gains of business or profession", so that brought forward loss from specified business relating to P.Y.2015-16 can be set-off against profits of specified business of the P.Y.2016-17.

For this purpose, while computing profits of textile manufacturing business included in the business income of ₹ 42.75 lakhs, the depreciation as per books of account has to be added back and the depreciation as per the Income-tax Act, 1961 has to be reduced from the net profit of ₹ 10.25 lakhs pertaining to textile business, since the depreciation adjustments clearly relate to textile business.

There is no effect of adjustment of partners' remuneration, since the entire remuneration which has been added back is allowable as the same is within the limits as per section 40(b)(v).

Question 13

Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lacs for the year ended 31-3-2017. The firm has not undertaken any international transaction or specified domestic transaction during the said year.

The above includes a profit of ₹ 220 lacs from an industrial undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IA of the Income-tax Act, 1961 is available to the extent of ₹ 200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7.12.2017, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 30-09-2017 or when the same is filed on 7-12-2017.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income?

Answer

As per section 80AC, while computing the total income of an assessee of a previous year ***(P.Y.2016-17, in this case)*** relevant to any assessment year ***(A.Y.2017-18, in this case)***, any deduction is admissible, *inter alia,* under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' specified in section 139(1).

Since the turnover of the partnership firm has exceeded Rs.200 lacs in the previous year 2016-17, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2017-18 would be 30th September, 2017 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y.2017-18

I. Where the firm files its return of income on 30th September 2017:

Particulars	₹ in lacs
Gross Total Income	300.00
Less: Deduction under section 80-IA	200.00
Total Income	**100.00**
Tax liability@ 30%	30.00
Add: Education cess@2% and secondary and higher education cess@1%	0.90
Regular income-tax payable	**30.90**
Computation of Alternate Minimum Tax payable [Section 115JC]	
Total Income	100.00
Add: Deduction under section 80-IA	200.00
Adjusted Total Income	**300.00**

Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lacs	**55.50**
Add: Surcharge@12% (Since adjusted total income > ₹ 1 crore)	6.66
	62.16
Add: Education cess@2% and SHEC@1%	1.86
Total tax payable (AMT)	**64.02**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2016-17 and it shall be liable to pay income-tax on such total income@18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y.2017-18 would be ₹ 64.02 lacs.

Tax credit for Alternate Minimum Tax [Section 115JD]	₹ in lacs
Total tax payable for A.Y.2017-18 (Alternate Minimum Tax)	64.02
Less: Regular income-tax payable	30.90
To be carried forward for set-off against regular income-tax payable (upto a maximum of ten assessment years).	33.12

II. Where the firm files its return of income on 7th December 2017:

Where the firm files its return on 7-12-2017, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of ₹ 300 lacs would be the total income of the firm.

Particulars	₹ in lacs
Income-tax@30% of ₹ 300 lacs	90.000
Add: Surcharge@12% (since total income exceeds ₹ 100 lacs)	10.800
Income-tax (plus surcharge)	100.800
Add: Education cess@2% and SHEC@1%	3.024
Total tax liability	**103.824**

Practical solution regarding obtaining clarifications

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date' 30.9.2017 and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹ 200 lacs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2019 (i.e., within one year from the end of A.Y.2017-18) which would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 30.9.2017, its tax liability would stand reduced to ₹ 64.02 lacs, as against ₹ 103.824 lacs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of ₹ 33.12 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2017.

Note: *Students may note that the Finance Act, 2016 has substituted section 139(5) by which a return furnished before the 'due date' specified in section 139(1) and a return filed under section 139(4) is eligible to be revised from the assessment year 2017-18 onwards. However, there is no such relaxation of conditions in section 80AC and hence to avail the benefits of certain deductions admissible under sections 80-IA, 80-IB, 80-IC, 80-ID, 80-IE the return has to be filed before the `due date' specified in section 139(1).*

Question 14

ABC LLP, a limited liability partnership in India is engaged in development of software and providing IT enabled services through two units, one of which is located in a notified Special Economic Zone (SEZ) in Chennai (commenced from 01.04.2012). The particulars relating to previous year 2016-17 furnished by the assessee are as follows:

Total Turnover: SEZ unit ₹ 120 lakhs and the other unit ₹ 100 lakhs

Export Turnover: SEZ unit ₹ 100 lakhs and the other unit ₹ 60 lakhs

Profit: SEZ unit ₹ 48 lakhs and the other unit ₹ 42 lakhs.

Amount debited to Profit and Loss Account towards Special Economic Zone Re-Investment Reserve Account Rs.18 lakhs.

The assessee has no other income during the year.

(i) Compute tax payable by ABC LLP for the Assessment Year 2017-18.

(ii) Will the amount of tax payable change, if ABC LLP is an overseas entity?

Answer

(i) Computation of total income and tax liability of ABC LLP as per the normal provisions of the Act for A.Y. 2017-18

Particulars		₹ (in lakh)
Business income (before deduction under section 10AA) (₹ 48 lacs + ₹ 42 lacs)		90.00
Add: Amount debited to SEZ Re-investment Reserve		18.00
		108.00
Less: Deduction under section 10AA		
=₹ 48 lacs× ₹ 100 lacs / ₹ 120 lacs = 40 X 50% (being the 6th year)	20.00	
Amount debited to SEZ Re-investment Reserve Account	18.00	
- Whichever is less is deductible		**18.00**
Total Income		**90.00**
Tax on total income@30%		27.00
Add: Education cess @2% & SHEC @1%		0.81
Tax liability (as per normal provisions)		**27.81**

Computation of Adjusted total income and Alternate Minimum tax of ABC LLP as per the provisions of section 115JC for A.Y. 2017-18

Particulars	₹ (in lakh)
Total income as per the normal provisions	90.00
Add: Deduction under section 10AA	18.00
Adjusted total income	108.00
Tax@18.5% of Adjusted Total Income	19.9800
Add: Sucharge @12% as the adjusted total income is >1 crore	2.3976
	22.3776
Add: Education cess @2% & SHEC @1%	0.6713
Alternate Minimum Tax as per section 115JC	**23.0489**

Since the tax payable as per the normal provisions of the Act is more than the alternate minimum tax payable, the total income as per normal provisions shall be liable to tax and the tax payable for A.Y. 2017-18 shall be ₹ 27.81 lakhs.

There would be no tax credit for ABC LLP to carry forward and set off against income-tax payable in the subsequent 10 assessment years.

(ii) The provisions of alternate minimum tax would also be applicable to an overseas LLP. Hence, the tax liability would remain the same even where ABC LLP is an overseas entity.

Question 15

(i) Who shall verify the return of income of a limited liability partnership?

(ii) XYZ LLP is liquidated. What is the liability of partners of XYZ LLP in respect of its tax dues?

(iii) PQR LLP has a profit of ₹ 500 lacs after charging interest on capital for P amounting to ₹ 15 lacs calculated at 15% p.a. as per the agreement, but before considering remuneration to partners. What is the maximum admissible amount of remuneration to partners assuming all the partners are working partners and remuneration is authorized by the LLP instrument?

Answer

(i) Under section 140, in the case of a limited liability partnership (LLP), the return of income shall be verified by the designated partner.

Where for any unavoidable reason, such designated partner is not able to verify the return, or where there is no designated partner as such, the return of LLP can be verified by any partner.

(ii) Section 167C provides for the liability of partners of LLP in liquidation. In the case of liquidation of an LLP and where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP.

(iii) Computation of maximum admissible remuneration to working partners

Particulars	**₹ (in lacs)**
Net profit before considering partners' remuneration	500
Add: Interest to Partner, P, in excess of 12% p.a. [₹ 15 lacs × 3 /15]	3
Book profit under section 40(b)	503
Maximum amount admissible as remuneration to working partners under section 40(b) :	
On first ₹ 3 lacs of book profit, 90%	2.70
On balance of book profit i.e. ₹ 500 lacs at 60%	300.00
Maximum admissible remuneration	302.70

Question 16

M/s. Harilal Industries, a partnership firm, submits the following profit and loss account for computation of its business income for the assessment year 2017-18:

Profit and loss account for the year ending 31.03.2017

Expenses	₹	*Income*	₹
To Salaries	*4,23,000*	*By gross profit*	*7,47,300*
" Rent	*32,000*	*By Dividend from UTI*	*8,000*
" Printing & Stationery	*5,600*		
" Telephone	*3,700*		
" Conveyance	*21,000*		
" Travelling	*14,000*		
" Interest	*72,000*		
" Depreciation	*27,000*		
" Legal fees	*15,000*		
" Audit fees	*18,000*		
" PF contribution	*24,000*		
" Net profit	*1,00,000*		
Total	***7,55,300***	***Total***	***7,55,300***

Additional information:

(i) Salaries include ₹ 1,50,000 paid to working partner A and ₹ 1,00,000 to working partner B. (authorized by the partnership deed)

(ii) Interest paid includes ₹ 54,000, being interest paid on loan given by partner B at the rate of 18% simple interest authorised by the partnership deed.

(iii) Out of provident fund contribution debited to profit and loss account, ₹ 10,000 remains outstanding beyond the 'due date' of filing of return specified in section 139(1).

(iv) The firm purchased goods by issuing account payee drafts except in the case of one bill for ₹ 80,000 for which payment has been made by cash. This has been debited to trading account as part of purchases.

Answer

Computation of business income of M/s. Harilal Industries for the A.Y 2017-18

Particulars	₹	₹
Net Profit as per Profit & Loss Account		1,00,000

Add : Remuneration to partners (considered separately)		2,50,000
		3,50,000
Add: Inadmissible expenses :		
Interest [₹ 54,000 – ₹ 36,000 (calculated@12%)]	18,000	
Provident fund payment outstanding as on due date of filing of return - disallowed under section 43B	10,000	
Cash purchases [disallowed under section 40A(3)]	80,000	1,08,000
		4,58,000
Less : Amount credited but exempt :		
Dividend from UTI [exempt under section 10(35)]		8,000
Book Profit		4,50,000
Less : Remuneration to partners deductible (See Note below)		2,50,000
Taxable business income		**2,00,000**

Note :

Computation of remuneration allowable as deduction as per 40(b)(v)

Particulars	Percentage allowable	₹
On first 3,00,000 of book profit	90%	2,70,000
On the balance book profit of ₹ 1,50,000	60%	90,000
Remuneration allowable as per 40(b)(v)		**3,60,000**

Since the actual remuneration of ₹ 2,50,000 is less than the allowable limit of ₹ 3,60,000, the entire remuneration of ₹ 2,50,000 is deductible.

Question 17

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2015-16, one partner 'A' retired, but his dues have been settled in the previous year 2016-17.

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2016 to authorise payment of remuneration of ₹ 1 lac per month to each working partner and simple interest at 15% per annum on partners' capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2017 shows a net profit of ₹ 10 lacs after debiting/crediting the following:

(a) *Interest amounting to ₹ 5 lacs each was paid to partners on the balances standing to their capital accounts from 1st June, 2016 to 31st March, 2017.*

(b) *Remuneration to the partners including partner in representative capacity ₹ 30 lacs.*

(c) *Interest amounting to ₹ 2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.*

(d) *Royalty of ₹ 5 lacs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.*

(e) *Two separate payments of ₹ 18,000 and ₹ 15,000 made in cash on 1st February, 2017 to Altaf, a hairdresser, against his bill for services rendered in January, 2017 and two payments of ₹ 19,000 and ₹ 10,000 made in cash on 1st February and 2nd February, 2017, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2017.*

(f) *Amount of ₹ 5 lacs provided in the books on 31st March 2017 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2017.*

(g) *Amount of ₹ 6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is ₹ 1.50 lacs.*

(h) *Interest of ₹ 1.20 lacs received on income-tax refund under section 244(1A) in respect of A.Y. 2014-15.*

The firm has also provided the following additional information:

The amount due to A, an ex-partner, was ₹ 15 lacs which was settled on 30th September, 2016 by transferring a plot of land purchased two years back having book value of ₹ 10 lacs. The difference of ₹ 5 lacs was credited to partners' capital accounts in their profit sharing ratio. The value of plot for stamp duty valuation on the date of transfer was ₹ 16 lacs.

Compute the total income of the firm for the assessment year 2017-18 stating the reasons for treatment of each item.

Answer

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2017-18

Particulars	₹	₹
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% **(Note 1)**	3,00,000	
Disallowance under section 40A(3A) for aggregate cash payment exceeding ₹ 20,000 in a single day **(Note 5)**	33,000	

Provision for gratuity **(Note 8)**	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X **(Note 4)**	5,00,000	42,83,000
		52,83,000
Less: Interest on income-tax refund **(Note 9)**		1,20,000
Book Profit		**51,63,000**
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first ₹ 3,00,000 — 90%	2,70,000	
On the balance ₹ 48,63,000 — 60%	29,17,800	
	31,87,800	
(ii) Remuneration actually paid or payable		
(₹ 1,00,000 × 10 months × 3 partners) + (Royalty ₹ 5 Lacs)		
(i) or (ii) whichever is less, is deductible	35,00,000	31,87,800
		19,75,200
Capital Gain		
Short-term capital gain on transfer of land **(Note 10)**		6,00,000
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		**26,95,200**
Deductions under Chapter VI-A		Nil
Total Income		**26,95,200**

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June, 2016 to 31st March, 2017 is to be disallowed. Excess interest of 3% being ₹ 15,00,000 x 3/15 = ₹ 3,00,000.
2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).*
3. As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest

payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of ₹ 5 Lacs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3A) provides for disallowance of any expenditure which was allowed in the earlier year and the actual payment was made subsequently and where the aggregate payment so made is otherwise than by an account payee cheque or account payee bank draft in a single day to a person exceeding a sum of ₹ 20,000. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2017 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 20,000.

6. The payment of bill of the assistant cameraman of ₹ 19,000 and ₹ 10,000 respectively on 1st February and 2nd February is not liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has not exceeded ₹ 20,000.

7. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2017 has to be deposited latest by 31st July 2017/ 30th September, 2017 (as the case may be). The firm has paid the tax on 3rd June, 2017 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

8. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of ₹ 1.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lacs (i.e., ₹ 6 lacs – ₹ 1.50 lacs) is to be disallowed.

9. Interest on income-tax refund is assessable under the head "Income from other sources".

10. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [*CIT vs. A. N .Naik Associates (2004) 265 ITR 346 (Bom.)]*. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

₹ 16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be ₹ 6 lacs (i.e., ₹ 16 lacs – ₹ 10 lacs).

Question 18

HSP, a partnership firm engaged in the business of running a hotel provides the following information relating to the year ended on 31.3.2017:

(a) Net profit as per P & L account of ₹ 200 lacs was arrived at after debiting the following:

(i) Depreciation on hotel building having W.D.V. on 1.4.2016 of ₹ 500 lacs was charged at the rate applicable for plant and machinery.

(ii) Expenses of ₹ 1,00,000 incurred for the purpose of promoting family planning among its employees.

(iii) Payment of ₹ 50,000 for an advertisement published in the souvenir released on 15th August by a political party.

(iv) Compensation of ₹ 2,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after receipt of 50% of appliances.

(v) Wines and liquor imported in F.Y. 2015-16 for ₹ 20 lacs of which stocks held as on 01.04.2016 at cost ₹ 5 lacs. Entire stock so held were confiscated by the Govt. authority during the year and hence was written off.

(vi) Expenses of ₹ 20 lacs incurred on replacement of carpets in the foyer, lounge and bar.

(b) Amount of ₹ 4 lacs equal to U.K. £4000 was remitted and paid to travel agent who is a resident of U.K. as commission for the booking of international tourists in the hotel. Tax at source was not deducted out of such payment. The said commission is charged to profit & loss account.

(c) Amount of ₹ 40,000 each was paid in cash to the suppliers of vegetables, milk products and eggs on 05.09.2016 because of suspension of banking operations due to strike of bank employees. The expenditure was debited to profit & loss account.

(d) Out of an amount of ₹ 5 lacs written off in the F.Y. 2012-13 as irrecoverable from a travel agent; ₹ 2 lacs was recovered on 13.3.2017 and credited to a reserve account.

Compute the Gross Total Income for A.Y. 2017-18 and give reasons in brief for treatment of each of the items.

Answer

Computation of total income of M/s. HSP for the A.Y.2017-18

Particulars	₹	
Income from business and profession		
Net profit as per profit and loss account		2,00,00,000

Add : **Items charged in profit and loss account which are not allowable**		
Excess depreciation on building @ 5%(i.e. 15% - 10%) on ₹ 500 Lacs **(Note 1)**	25,00,000	
Expenses on promoting family planning amongst the employees **(Note 2)**	1,00,000	
Advertisement in souvenir of a political party **(Note 3)**	50,000	
Compensation to a supplier of kitchen appliances **(Note 4)**	2,00,000	28,50,000
Add : Recovery of bad debts credited in reserve but chargeable under section 41(4) **(Note 9)**		2,00,000
Gross Total Income		**2,30,50,000**

Notes:-

(1) Hotel building is not a plant and machinery. Depreciation rate applicable to it is 10%. However, depreciation has been charged in the profit and loss account at the rate applicable to plant and machinery i.e. @ 15%. Accordingly, the excess depreciation charged in the profit and loss account @ 5% (15%-10%) is added to the income.

(2) Expenses on promoting family planning amongst employees is allowable under section 36(1)(ix) only to a company assessee. In this case, since the assessee is a firm, such expenses are not allowable and therefore, the same is added back.

(3) Advertisement of any nature given in a magazine / souvenir published by a political party is not allowable as per section 37(2B).

(4) 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.* Accordingly, the same is disallowed and added to the income.

(5) 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. *Explanation* to section 37(1) is not relevant here since it is not a case of business expenditure but one of business loss. Business loss is allowable on ordinary commercial principles. Therefore, since wine and liquor formed part of stock-in-trade of the firm, confiscation of the same is allowed as business loss.

(6) The expenditure incurred on replacement of carpets by a hotel are in the nature of expenses incurred for the purposes of business and are allowable as revenue expenses under section 37(1).

(7) Payment in foreign currency to a non-resident outside India without deduction of tax at source is an allowable expense notwithstanding the withdrawal of *CBDT Circular No.786 dated 7.2.2000* by means of *Circular No.7 of 2009 dated 22.10.2009,* as no income accrued

or arose to the non-resident in India. It is assumed that compliance with section 195(6) is made in this case.

(8) The cash payments made totaling ₹ 1,20,000 (40,000 each to suppliers of vegetables, milk products and eggs) on the day when bank employees were on strike is an exception as per rule 6DD(k). Therefore, disallowance under section 40A(3) is not attracted.

(9) Recovery of a debt which was earlier written off under section 36(1)(vii) and was allowed as deduction is chargeable to tax under section 41(4) in the year of such recovery. Accordingly, such amount has to be added to income despite the fact that the same was credited by the firm in a reserve account.

Question 19

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2010. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to ₹ 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2016 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2010, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2016.

The firm was dissolved on 31.3.2017 and the capital assets of the firm were distributed among the partners on 20.4.2017. The net profit of the firm for the year ended 31.3.2017 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was ₹ 1,50,000:

(i) Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2016 to 31.3.2017.

(ii) Interest amounting to ₹ 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2016 to 31.3.2017

(iii) Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.

(iv) Payment of ₹ 25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2016.

(v) ₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.

(vi) Depreciation amounting to ₹ 15,000 on motor car bought and used exclusively for business purposes, but registered in the name of partner 'H'.

(vii) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2016 at a cost of ₹ 5,00,000..

(viii) Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a) *Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock-in-trade was ₹ 65,000.*

(b) *Brought forward business loss relating to the assessment year 2016-17 was ₹ 50,000.*

(c) *The fair market value of the capital assets as on 31.3.2017 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.*

Compute the total income of M/s. HIG for the assessment year 2017-18.

You are required to furnish explanations for the treatment of the various items given above.

Answer

Computation of total income of M/s. HIG for the A.Y. 2017-18

Particulars	₹	₹
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2016 to 30.9.2016 disallowed (total interest ₹ 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note (i)]**	50,000	
Interest to partners on current accounts from 1.4.2016 to 31.3.2017–not authorized by the deed, hence disallowed **[Note (ii)]**.	50,000	
100% of ₹ 25,000 paid towards purchase of television sets otherwise than by way of account payee cheque (being stock in trade, hence disallowed) **[Note (iv)]**.	25,000	
Difference on account of valuation of closing stock-in-trade at market value (₹ 65,000 less ₹ 60,000) **[Note (ix)]**	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		5,30,000
Less: Additional depreciation on new machinery (₹ 5,00,000 20%) = ₹ 1,00,000. Only 50% is allowable as deduction. **[Note (vii)]**		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first ₹ 3,00,000 @ 90%	2,70,000	

On the balance of ₹ 1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less: Business loss relating to assessment year 2016-17 set off		50,000
Income from business		**1,55,000**
Income from other sources		
Interest received from bank on fixed deposits		25,000
Total Income		**1,80,000**

Explanation for the treatment of various items

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2016 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2016. Interest for the period prior to 1.10.2016 is not allowed.

(ii) The partnership deed of 1.10.2016 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).

(iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque / account payee bank draft. Since the firm has made payment of ₹ 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at ₹ 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II : Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the net realizable value.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2016-17 is not considered for calculation of book-profit.

(xi) Section 45(4) is not applicable to the firm for the assessment year 2017-18, though the dissolution of the firm took place on 31.3.2017, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2017. The capital gains will, therefore, be assessable in the assessment year 2018-19.

Question 20

A firm consisting of four partners was dissolved consequent to the death of one of the partners. The remaining partners reconstituted the firm immediately, without discontinuance of the business, and carried on the business as before. The inventory of stocks on the date of dissolution was valued at cost, which was lower than the market value and all other assets were valued at book value, for the purpose of transfer to the reconstituted firm. The Assessing Officer, while arriving at the total income of the firm was constituted prior to dissolution, valued the stocks as well as the other assets at market value. You are required to comment on the correctness of the Assessing Officer's action.

Answer

As per para 24 of ICDS II: "Valuation of Inventories", in case of dissolution of a partnership firm or association of persons or body of individuals, whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value.

In the present case, even though the firm was reconstituted without discontinuance of the business, the stocks have to be valued at net realisable value. Hence, the action of the Assessing Officer is correct.

In respect of other assets, section 45(4) will apply and hence other assets have to be valued at fair market value for the purpose of computing capital gains upon dissolution of firm due to death of a partner. The fair market value on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. Section 45(4) would be applicable only in the year where the distribution of assets takes place consequent to dissolution.

Note: Students may note that the apex court in *Sakthi Trading Co v. CIT (2001) 250 ITR 871 (SC)* has held where a firm is dissolved due to death of a partner and the surviving partners continue the business of the firm as before, the firm is entitled to value inventory at cost or market price whichever is lower. Since the business is not discontinued, the inventory need not be valued at the net realisable value. The decision of the Supreme Court is based on the accounting principles and interpretation of section 28(i) of the Act. Since the statute is interpreted and decided by the apex court, it is possible to answer the question by saying that the action of the Assessing officer is not tenable in law.

Question 21

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2016 after a search. The tax liability of the firm outstanding to be paid was determined at ₹ 15 Lacs. Out of three partners, one was declared insolvent on 18-03-2017 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of ₹ 6 Lacs from the Account of one such partner. You are asked by the partners of the dissolved firm the following questions:

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer is justified to attach the Bank Account of partners to recover the tax demand of the dissolved firm?

Answer

(i) As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore, the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of ₹ 15 Lacs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of ₹ 6 Lacs recovered by attachment of the bank account of one of the partners is also in order.

Assessment of Companies

Question 22

Sona Ltd., a resident company, earned a profit of ₹ 15 lakhs after debit/credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2017:

(i) Items debited to Statement of Profit and Loss:

No.	Particulars	₹
1.	*Provision for the loss of subsidiary*	*70,000*
2.	*Provision for doubtful debts*	*75,000*
3.	*Provision for income-tax*	*1,05,000*
4.	*Provision for gratuity based on actuarial valuation*	*2,00,000*
5.	*Depreciation*	*3,60,000*
6.	*Interest to financial institution (unpaid before filing of return)*	*1,00,000*
7.	*Penalty for infraction of law*	*50,000*

(ii) Items credited to Statement of Profit and Loss:

No.	Particulars	₹
1.	*Profit from unit established in special economic zone.*	*5,00,000*
2.	*Share in income of an AOP as a member*	*1,00,000*
3.	*Income from units of UTI*	*75,000*
4.	*Long term capital gains*	*3,00,000*

Other Information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation as per Income-tax Rules is ₹ 2,80,000.

(iii) Balance of Statement of Profit and Loss shown in Balance Sheet at the asset side as at 31/03/2016 was ₹ 10 lakhs which includes unabsorbed depreciation of ₹ 4 lakhs.

(iv) The capital gain has been invested in specified assets under section 54EC.

(v) The AOP, of which the company is a member, has paid tax at maximum marginal rate.

(vi) Provision for income-tax includes ₹ 45,000 of interest payable on income-tax.

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2017-18.

Answer

Computation of "Book Profit" for levy of MAT under section 115JB for A.Y.2017-18

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		15,00,000
Add: Net profit to be increased by the following amounts as per *Explanation 1* to section 115JB:		
- Provision for the loss of subsidiary	70,000	

- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	75,000	
- Provision for income-tax *Further, as per* Explanation 2 *to section 115JB, income-tax shall include, inter alia, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including ₹45,000 towards interest payable has to be added]*	1,05,000	
- Depreciation	3,60,000	6,10,000
		21,10,000
Less: Net profit to be decreased by the following amounts as per *Explanation 1* to section 115JB:		
- Share in income of an AOP as a member *[In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to profit and loss account]*	1,00,000	
- Income from units in UTI *[Income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]*	75,000	
- Depreciation other than depreciation on revaluation of assets (₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. *Lower of unabsorbed depreciation ₹ 4,00,000 and brought forward business loss ₹6,00,000 as per books of accounts has to be reduced while computing the book profit]*	4,00,000	7,85,000
Book Profit		13,25,000

Computation of MAT liability under section 115JB

Particulars	₹
18.50% of book profit	2,45,125
Add: Education cess@2%	4,903
Secondary and higher education cess@1%	2,451

Minimum Alternate Tax liability	2,52,479
MAT liability (rounded off)	2,52,480

Notes:

(1) It is only the specific items mentioned under *Explanation 1* to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability *[CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]*. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(4) Long-term capital gains cannot be deducted while computing book profit even if such amount of capital gains is invested in specified assets under section 54EC, since book profit has to be computed by adding/deducting the items mentioned under *Explanation 1* to section 115JB alone. Capital Gains reflected in the statement of profit and loss shall be part of book profit under section 115JB. Capital gains exempted under section 54EC cannot also be excluded for computing book profit. *[CIT v. Veekaylal Investment Co. P. Ltd. (2001) 249 ITR 597 (Bom.) & N J Jose and Co. (P) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)]*

Question 23

XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a net profit of ₹ 700 lakhs after debit/credit of the following items:

(1) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.

(2) Employer's contribution to EPF of ₹ 2 lakhs and Employees' contribution of ₹ 2 lakhs for the month of March, 2017 were remitted on 8th May 2017.

(3) The company appended a note to its Income Statement that industrial power tariff concession of ₹ 2.5 lakhs was received from the State Government and credited the same to P & L Account.

(4) The company had provided an amount of ₹ 25 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in 3 years. The provision is based on a fair estimation on wage and reasonable certainty of revision once in 3 years.

(5) *The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2017 was ₹ 200 lakhs.*

(6) *A debtor who owed the company an amount of ₹ 40 lakhs was declared insolvent and hence, was written off by debit to Profit and loss account.*

(7) *Sundry creditors include an amount of ₹ 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2017, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Profit and Loss account.*

(8) *The opening and closing stock for the year were ₹ 200 lakhs and ₹ 255 lakhs, respectively. They were overvalued by 10%.*

(9) *Provision for gratuity based on actuarial valuation was ₹ 500 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 300 lakhs.*

(10) *Commission of ₹ 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.*

(11) *The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is ₹ 28,000/ton.*

Additional Information:

(1) *There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2016, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.*

(2) *Normal depreciation calculated as per income-tax rules is Rs.80 lakhs.*

(3) *The company had credited a sub-contractor an amount of ₹ 10 lakhs on 31-03-2016 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2016.*

(4) *The company has collected ₹ 7 lakhs as sales tax from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Sales Tax Department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹ 2 lakhs to the customers from whom the amount was collected and the balance of ₹ 1 lakh is still lying under the head "Current Liabilities".*

Compute total income and tax payable. Ignore MAT provisions.

Answer

Computation of Total Income of XYZ Ltd. for the A.Y.2017-18

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		7,00,00,000

Add: **Items debited but to be considered separately or to be disallowed**			
(a) Depreciation as per Companies Act, 2013 disallowed	50,00,000		
(b) Employees contribution to EPF ***[See Note 1 below]*** *[Since employees contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va). Since the same has been debited to profit and loss account, it has to be added back for computing business income].*	2,00,000		
(c) Employers contribution to EPF *[As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1). Since the same has been debited to profit and loss account, no further adjustment is necessary]*	Nil		
(d) Industrial power tariff concession received from State Government *[Any assistance in the form of, inter alia, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to profit and loss account, no adjustment is required.*	Nil		
(e) Provision for wages payable to workers *[The provision is based on fair estimate of wages and reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to profit and loss account, no adjustment is required while computing business income]*	Nil		
(f) Provision for doubtful debts [10% of ₹ 200 lakhs] *[Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations and state industrial investment corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to profit and loss account, it has to be added back for computing business income]*	20,00,000		
(g) Bad debts written off *[Bad debts write off in the book of account is allowable as deduction under section 36(1)(vii). Since the same has*	Nil		

	already been debited to profit and loss account, no further adjustment is required]		
(h)	Discount given by Sundry Creditors for supply of raw materials *[Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to profit and loss account, no further adjustment is required]*	Nil	
(i)	Provision for gratuity *[Provision of ₹ 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]*	2,00,00,000	
(j)	Commission paid to recovery agent for realization of a debt. *[Commission of ₹ 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). Since the same has been debited to profit and loss account, no further adjustment is required]*	Nil	
(k)	Purchase of paper at a price higher than the fair market value *[As per section 40A(2), the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]*	10,00,000	
(l)	Sales tax not refunded to customers out of sales tax refund *[The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers [CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]. Hence, the net amount of ₹ 1,00,000 (i.e., ₹ 3,00,000 minus ₹ 2,00,000) would be chargeable to tax]*	<u>1,00,000</u>	2,83,00,000
			9,83,00,000
	<u>Less</u>: **<u>Items credited but to be considered separately/ permissible expenditure and allowances</u>**		
(m)	Depreciation as per Income-tax Act,1961 already debited in profit and loss account	80,00,000	
(n)	Over-valuation of stock [₹ 55 lakhs × 10/110]	5,00,000	

	[The amount by which stock is over-valued has to be reduced for computing business income. ₹ 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]		
(o)	Additional Depreciation ***[See Note 2 below]*** *[Additional depreciation@20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2016, as the same was put to use for more than 180 days in the P.Y.2016-17.]*	10,00,000	
(p)	Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return ***[See Note 3 below]*** *[30% of ₹ 10 lakhs, being payment to a sub-contractor, would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2016-17, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2017-18, since the remittance has been made on 31.12.2016]*	3,00,000	98,00,000
Total Income			**8,85,00,000**

Computation of tax liability of XYZ Ltd. for A.Y.2017-18

Particulars	₹
Tax @30% on the above total income	2,65,50,000
Add: Surcharge@7% (since total income exceeds ₹ 1 crore but less than ₹ 10 crore)	18,58,500
	2,84,08,500
Add: Education cess@2%	5,68,170
Secondary and higher education cess@1%	2,84,085
Total tax liability	2,92,60,755
Total tax liability (rounded off)	2,92,60,760

Notes:

(1) Employees contribution to PF deposited after the due date mentioned under the PF Act is not allowable as deduction as per section 36(1)(va). The same has also been affirmed by the Gujarat High Court in *CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170.* Hence, in the above solution, employees' contribution to PF has been disallowed while computing business income.

Alternate View *- An alternate view has, however, been expressed in CIT v. Kiccha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand), CIT v. AIMIL Ltd (2010) 321 ITR 508 (Del) and CIT v. Nipso Polyfabriks Ltd (2013) 350 ITR 327 (HP) that employees contribution to PF,* *deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing of return for the relevant previous year. If this view is considered, then no disallowance would be attracted in this case, since the employees' contribution has been remitted before the due date of filing of return of income.*

(2) ₹ 50 lakhs, being the addition to plant and machinery on 1.6.2016 qualifies for additional depreciation@20% under section 32(1)(iia). Since only the normal depreciation as per Income-tax Rules, 1962, has been debited to profit and loss account, additional depreciation of ₹ 10 lakhs (being 20% of ₹ 50 lakhs) has to be deducted while computing business income.

(3) Since the tax deducted during the P.Y.2015-16 was remitted only on 31.12.2016, i.e., after the due date of filing of return for A.Y.2016-17, ₹ 3,00,000, being 30% of ₹ 10 lakh would have been disallowed while computing the business income of that year. Since the tax deducted has been remitted on 31.12.2016, ₹ 3,00,000 would be allowed as deduction while computing the business income of the A.Y.2017-18.

Question 24

Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The Company's Statement of Profit and Loss for the previous year ended 31st March, 2017 shows a net profit of ₹ 152 lakhs after debiting or crediting the following items:

(a) Payment of ₹ 0.25 lakh and ₹ 0.30 lakh in cash on 3rd December, 2016 and 10th December, 2016 respectively for purchase of crab, lobster and squid to Mr. Raja, a fisherman, and Mr. Khalid, a middleman for these products, respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of ₹ 3 lakhs calculated at 12% of basic salary and Dearness Allowance payable to the employees.

(c) Payment of ₹ 6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.

(d) Profit of ₹ 12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June, 2015.

(e) Contribution of ₹ 2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.

(f) Expense of ₹ 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed and the project was abandoned.

(g) Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.

(h) Depreciation charged ₹ 10 lakhs.

(i) ₹ 10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2013-14.

(j) Dividend received from a foreign company ₹ 5 lakhs.

Additional information:

(i) As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March, 2016 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March, 2017 by debiting new loan account.

(ii) Depreciation as per Income-tax Act, 1961 ₹ 15 lakhs.

(iii) The company received a bill for ₹ 2 lakhs on 31st March 2017 from a supplier of vegetables for supply made in March, 2017. The bill was omitted to be recorded in the books in March, 2017. The bill was paid in April, 2017 and the necessary entry was made in the books then.

Compute total income of Parik Hospitality Limited for the Assessment Year 2017-18 indicating the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax.

Answer

(a) Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2017-18

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		1,52,00,000
***Add:* Items debited but to be considered separately or to be disallowed**		
(a) Payment to middleman for purchase of crab etc. in an amount exceeding ₹ 20,000	30,000	
[Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 20,000 is made on a day to a person. Payment of ₹ 25,000 to fishermen for purchase of crab etc. is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to middlemen for purchase of crab etc. is not covered under the exception - *CBDT Circular 10/2008 dated 5/12/2008*].		

(b)	Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9) [Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). In this case, it is presumed that dearness allowance forms part of pay for retirement benefits]	50,000	
(c)	Payment to transport contractor without deduction of tax at source [Since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].	-	
(f)	Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize [Where expenditure is incurred for a project not related the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per *McGaw-Ravindra Laboratories (India) Ltd. v. CIT* (1994) 210 *ITR* 1002 *(Guj.)*. Brewery project is not related to the existing business of running three star hotels]	10,00,000	
(g)	Fees paid to directors without deducting tax at source [30% of ₹1 lakh] [Disallowance@30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]	30,000	
			11,10,000
			1,63,10,000
Less:	**Items credited but to be considered separately / Expenditure to be allowed**		
(d)	Profit on sale of plot of land to 100% subsidiary [Short-term capital gains arises on sale of plot of land held for less than 36 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been	12,00,000	

	credited to the statement of profit and loss, the same has to be deducted for computing business income].		
(e)	Contribution to IIT for scientific research [Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for weighted deduction@200% under section 35(2AA). Since 100% of contribution has already been debited to the statement of profit and loss, the balance 100% has to be deducted while computing business income][3].	2,50,000	
(h)	Depreciation [Depreciation allowable under the Income-tax Act, 1961 is ₹15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the additional amount of ₹ 5 lakhs has to be deducted while computing business income]	5,00,000	
(i)	Additional compensation received from State Government [Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	10,00,000	
(j)	Dividend received from foreign company [Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	5,00,000	
(i)	Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2	2,00,000	

[3] From assessment year 2018-19 it is eligible for deduction @ 150% and from the assessment year 2021-22 it is deductible @ 100%

lakhs has been paid in the P.Y.2016-17, the same is allowable as deduction]		
(iii) Purchases omitted to be recorded in the books	2,00,000	
[Since the purchase is made in March, 2017 (i.e., P.Y.2016-17), in respect of which bill of ₹ 2 lakhs received on 31.3.2017 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income *[Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]*. It is logical to assume that the company is following mercantile system of accounting.].		
		38,50,000
Income under the head "Profits and Gains of Business or Profession"		**1,24,60,000**
Income from Other Sources		
Dividend received from foreign company		5,00,000
[Dividend received from a foreign company is chargeable to tax under the head "Income from other sources".[4]]		
Gross Total Income		**1,29,60,000**
Less: Deduction under Chapter VI-A		Nil
Total Income		**1,29,60,000**

Question 25

XYZ Ltd. is engaged in the business of manufacturing fertilizers since 1st April 2009. Its profit and loss account shows a net profit of ₹ 500 lakhs for the year ended 31-03-2017 after debiting and crediting the following items:

- *Depreciation provided in accounts as per straight line basis ₹ 30 lakhs.*

  Note: Normal depreciation allowable as per the Income-tax Rules, 1962 is ₹ 48 lakhs.

- *The company has made cash payments for purchases and expenditure as below:*

  On 04-06-2016 ₹ 5 lakhs (Due to strike by bank staff)

  On 05-06-2016 ₹ 7 lakhs (Due to cash demanded by the supplier)

  On 01-04-2016 ₹ 10 lakhs (a bank holiday)

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[4] Only dividend received from domestic companies would be exempt under section 10(34), since dividend distribution tax is paid by the companies on such dividend.

Cash payments made to transport operator for hiring of lorry are as follows:

07-05-2016 ₹ 50,000; 08-01-2017 ₹ 75,000; 02-03-2017 ₹ 32,000.

- *₹ 5 lakhs contribution to a University approved and notified under section 35(1)(ii).*
- *Sales tax of ₹ 1.45 lakhs, pertaining to the year ended 31-03-2016, was paid on 10-12-2016.*
- *Rent paid and professional charges to a consultant including service tax was ₹ 5,72,500 and ₹ 2,29,000 respectively. Tax was not deducted on the service tax portion for both the payments.*
- *The company has also purchased goods of ₹ 55 lakhs from M/s. ABC Ltd. in which Directors have substantial interest. The market value of the goods is ₹ 54 lakhs.*
- *The company has incurred legal expenses for the following:*

  Issue of Bonus shares ₹ 10 lakhs.

  Alteration of Memorandum of Association ₹ 2 lakhs (in connection with increase of authorized capital).
- *Donation paid to a political party ₹ 25 lakhs - by way of cheque.*

Compute the total income and tax payable by the company for the assessment year 2017-18. Ignore MAT provisions.

Answer

Computation of Total Income of XYZ Ltd. for the A.Y.2017-18

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		5,00,00,000
Add: Items debited but to be considered separately or to be disallowed		
Depreciation provided on straight line basis **(Note 1)**	30,00,000	
Disallowance under section 40A(3) for payment exceeding ₹ 20,000 made in cash for purchases and expenditure **(Note 2)**	7,00,000	
Disallowance under section 40A(3) for cash payment exceeding ₹ 35,000 in a day to transport operators for hiring of lorry **(Note 3)**	1,25,000	
Contribution to University (considered separately for weighted deduction) **(Note 4)**	5,00,000	
Sales tax of P.Y.2015-16 paid on 10.12.2016 **(Note 5)**	-	

Rent and Professional charges paid to consultant, on which tax has not been deducted on the service tax component **(Note 6)**	-	
Disallowance under section 40A(2) for excess payment to related person **(Note 7)**	1,00,000	
Legal expenses for issue of bonus shares **(Note 8)**	-	
Legal expenses for alternation of memorandum of association **(Note 8)**	2,00,000	
Donation to political party **(Note 9)**	25,00,000	71,25,000
		5,71,25,000
***Less:* Items credited but to be considered separately or to be allowed**		
Depreciation allowable under the Income-tax Act, 1961 (Note 1)	48,00,000	
Weighted deduction @ 175% in respect of contribution of ₹ 5 lakhs to a University approved and notified under section 35(1)(ii) **(Note 4)**	8,75,000	56,75,000
Gross Total Income		**5,14,50,000**
***Less:* Deduction under Chapter VI-A**		
Under section 80GGB [Donation to political party] **(Note 9)**		25,00,000
Total Income		**4,89,50,000**

Computation of tax liability of XYZ Ltd. for A.Y.2017-18

Particulars	₹
Tax@30% on total income of ₹ 4,89,50,000	1,46,85,000
Add: Surcharge@7% (since total income exceeds ₹ 1 crore but does not exceed ₹ 10 crores)	10,27,950
Tax payable including surcharge	1,57,12,950
Add: Education cess@2% and secondary and higher education cess@1%	4,71,389
Total tax payable	**1,61,84,339**

Notes:

(1) Depreciation provided in the accounts on straight line basis (i.e., ₹ 30 lakhs) has to be added back and depreciation calculated as per Income-tax Rules, 1962 (i.e. ₹ 48 lakhs) is allowable as deduction under section 32.

(2) Cash payments exceeding ₹ 20,000 a day attracts disallowance under section 40A(3). However, Rule 6DD provides for certain exceptions, which includes, *inter alia,* payments which are required to be made on a day on which the banks were closed either on account of holiday or strike. Therefore, cash payment of ₹ 5 lakhs made on the day of strike by bank staff and cash payment of ₹ 10 lakhs made on a bank holiday would not attract

disallowance under section 40A(3), assuming such payments were required to be made on those specific dates. However, cash payment of ₹ 7 lakhs made on 5-6-2016 due to demand of supplier would attract disallowance under section 40A(3), since the same is not covered under any of the exceptions laid out in Rule 6DD.

(3) In respect of cash payments to transport operators, a higher limit of ₹ 35,000 per day is permissible. Therefore, cash payment of ₹ 32,000 on 2-3-2017 would not attract disallowance under section 40A(3). However, cash payments of ₹ 50,000 and ₹ 75,000 on 7.5.2016 and 8.1.2017, respectively, would attract disallowance under section 40A(3) since the same exceeds ₹ 35,000 per day.

(4) Contribution to a university approved and notified under section 35(1)(ii) qualifies for weighted deduction@175%. Hence, the contribution of ₹ 5 lakhs is first added back and thereafter, deduction of ₹ 8.75 lakhs (i.e.,175% of ₹ 5 lakhs) has been provided under section 35(1)(ii)[5].

(5) Sales tax liability of ₹ 1.45 lakhs pertaining to P.Y.2015-16 would have been disallowed under section 43B while computing business income of A.Y.2016-17, since it was paid only on 10.12.2016 (i.e., after the due date of filing return of income of that year). It would be allowed in the year of payment (i.e., P.Y.2016-17). Since it is already debited to profit and loss account, no further adjustment is required.

(6) Rent and professional charges have been debited to profit and loss account. It is stated that tax has not been deducted on the service tax component of rent and professional charges.

As per *CBDT Circular No. 4/2008 dated 28.4.2008*, service tax paid by a tenant does not par take the character of income of the landlord. Hence, tax is to be deducted at source under section 194-I on rent paid without including service tax.

Further, in respect of professional charges, *CBDT Circular No.1/2014 dated 13.1.2014* clarifies that if in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid/payable without including such service tax component.

Assuming that, in this case, the service tax component is indicated separately in the agreement/contract between the company and the consultant, tax is required to be deducted at source on the professional charges without including such service tax component. Therefore, no disallowance is attracted for non-deduction of tax at source on the service-tax component.

(7) ABC Ltd. is a related person under section 40A(2), since the directors of the XYZ Ltd. have substantial interest in ABC Ltd. Therefore, excess payment of ₹ 1 lakh to ABC Ltd. for purchase of goods would attract disallowance under section 40A(2).

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[5] W.e.f. A.Y 2018-19 it is eligible for 150% deduction and from A.Y.2021-22 it is eligible for only 100% deduction i.e. no weighted deduction would be allowable

(8) 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 ₹ 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.*

However, ₹ 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).*

***Note**: A view can also be taken that legal expenses in relation to alternation of memorandum of association in connection with enhancement of authorized capital is allowable as deduction, if the enhancement of capital was for the purpose of issuance of bonus shares.*

(9) Donation paid to a political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income. However, donation made by a company to a political party is allowable deduction under section 80GGB from gross total income, subject to the condition that payment is made otherwise than by way of cash. It is assumed that such donations are made to a political party registered under section 29A of the Representation of the People Act, 1951. Since the donation is made by cheque the same is allowed as deduction under section 80GGB.

Question 26

The Profit & Loss Account of ST Private Limited for the year ended 31st March, 2017 shows a profit of ₹ 75 lakhs after debiting the following items:

(i) ₹ 2 lakhs contributed to Employees' Welfare Trust.

(ii) ₹ 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.

(iii) ₹ 3.50 lakhs, being expenses incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.

(iv) ₹ 3 lakhs spent on gift items distributed to various dealers under the company's sales incentive scheme.

(v) ₹ 6 lakhs, being expenses incurred on the travelling of the wife of MD, who accompanied him on tour to Singapore on invitation of Trade and Commerce Chamber, Singapore.

(vi) ₹ 3 lakhs, being amount paid in March 2017 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the supplier of machinery. Machinery was put to use in July 2016.

(vii) *₹ 18,000 and ₹ 9,000 paid in cash on 25th October, 2016 by two separate vouchers to a contractor who carried out certain repair work in the office premises.*

(viii) *Interest of ₹ 2 lakhs was paid in March, 2017 to a company on a loan taken from a company. Tax deducted at source from such interest was deposited in July, 2017.*

Additional Information:

(a) *Provision for audit fee of ₹ 6 lakhs was made in the books for the year ended 31st March, 2016 without deducting tax at source. Such fee was paid to the auditors in September, 2016 after deducting tax under section 194J and the tax so deducted was deposited on 7th October, 2017.*

(b) *During the year, the company purchased 10,000 shares of VK Private Limited at ₹ 40 per share. The fair market value of such shares on the date of transaction was ₹ 60 per share.*

Compute total income of ST Private Limited for Assessment Year 2017-18 and tax payable on such income indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

Answer

Computation of total income of ST Private Ltd. for the A.Y.2017-18

Particulars	₹
Profits and gains of business or profession	
Net profit for the year as per profit and loss account	75,00,000
***Add:* Expenses debited to profit and loss account but not allowable**	
(i) Contribution to Employees Welfare Trust disallowed under section 40A(9)	2,00,000
(ii) Expenses on course fee and hostel expenses for MBA course of a close relative of a director, who is not in employment of ST Private Ltd., is not deductible under section 37 *[Enkay (India) Rubber Co. Pvt. Ltd v. CIT (2003) 263 ITR 521 (Del)].* Such expenditure is not incurred wholly and exclusively for the purposes of business. Hence, it should be added back to compute business income.	12,00,000
(iii) Expenses on installation of traffic signal, to facilitate its employees to overcome traffic jam and be on time, is in the interest of the business so that the work gets completed on time, and is hence, an allowable expense under section 37(1).	--
(iv) 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)]*.	--

(v) Expenses on travelling to Singapore of the wife of Managing Director on the invitation of Trade and Commerce Chamber, Singapore, is an allowable expense on the grounds of commercial expediency and business considerations.			--
(vi) Increase in liability due to change in currency rate and paid to the suppliers of machinery is to be added to cost of the asset irrespective of the method of accounting as per section 43A. Hence, it should be added back to compute business income.			3,00,000
(vii) Payments to a contractor for repair work in a day by two separate vouchers in cash, is not an allowable expense as per section 40A(3), since the aggregate payment in a day exceeds the limit of ₹ 20,000.			27,000
(viii) Interest of ₹ 2 lakhs paid in March, 2017, on which tax deducted at source was remitted to the Government before the due date of filing of return (i.e., before 30th September, 2017), is allowable as per section 40(a)(ia).			-
			92,27,000
Less: **Expenditure allowable as deduction but not debited to profit and loss account**			
Provision for audit fees for the year ended 31.3.2016 for which tax was not deducted in the F.Y. 2015-16 would have been disallowed to the extent of 30%. Since tax was deducted and paid in F.Y. 2016-17, the disallowed 30% is allowable as deduction in the A.Y.2017-18, as per proviso to section 40(a)(ia). **(Note -1)**		1,80,000	
Depreciation on the amount of ₹ 3 lakhs added in cost of machinery @ 15% for the year, since the machinery was put to use for more than 180 days **(Note - 2)**		45,000	2,25,000
			90,02,000
Income from other sources			
Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(viia). Since the difference exceeds ₹ 50,000, the entire sum is taxable.			2,00,000
Total income			**92,02,000**

Computation of tax liability of ST Private Ltd. for A.Y.2017-18

Particulars	₹
Tax on ₹ 92,02,000 @ 30%	27,60,600
Add: Education cess @ 2%	55,212
Secondary and higher education cess @ 1%	27,606
Total Tax Payable	**28,43,418**

Notes :

1. As per provisions of section 40(a)(ia), disallowance to the extent of 30% of sum payable is attracted in case the sum, on which tax is deductible is paid without deduction of tax or after deduction, the tax has not been paid on or before the due date as specified in section 139(1). Also, in case the tax is deducted in subsequent year, 30% of such sum shall be allowed as deduction in the previous year in which the tax has been deducted and paid.

   In the present case, 30% of audit fees would have been disallowed in A.Y. 2016-17 shall be allowed as deduction in the assessment year 2017-18 as the tax was deducted and remitted in the P.Y. 2016-17.

2. It is assumed that ST Private Limited is not a manufacturing concern, hence no additional depreciation is provided.

Question 27

XYZ Limited's Profit & Loss Account for the year ended 31st March, 2017 shows a net profit of ₹ 75 lakhs after debiting / crediting the following items:

(i) Depreciation ₹ 24 lakhs (including ₹ 4 lakhs on revaluation).

(Note: Depreciation allowable ₹ 27 lakhs as per Income-tax Rules, 1962)

(ii) Interest to financial institution not paid before 'due date' of filing return of income ₹ 6 lakhs.

(iii) Provision for doubtful debts ₹ 1 lakh.

(iv) Provision for unascertained liabilities ₹ 2 lakhs.

(v) Transfer to General Reserve ₹ 5 lakhs.

(vi) Net Agricultural Income ₹ 6 lakhs

(vii) Amount withdrawn from Reserve created during P.Y.2014-15 ₹ 3 lakhs.

(Book profit was increased by the amount transferred to such reserve in Assessment Year 2015-16)

Other Information:

Brought forward loss and unabsorbed depreciation as per books are ₹ 12 lakhs and ₹ 10 lakhs, respectively.

Compute minimum alternate tax under section 115JB for A.Y.2017-18.

Answer

Computation of Book Profit of XYZ Limited under section 115JB

Particulars	₹	₹
Net Profit as per profit and loss account		75,00,000
Add: **Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB**		
Transfer to General Reserve	5,00,000	

Provision for unascertained liabilities	2,00,000	
Provision for doubtful debts	1,00,000	
Depreciation	24,00,000	32,00,000
		1,07,00,000
***Less:* Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB**		
Amount transferred from reserve and credited to profit and loss account [since the book profit was increased by the amount transferred to such reserve in the assessment year 2015-16]	3,00,000	
Depreciation (excluding revaluation)	20,00,000	
Net Agricultural Income [Exempt under section 10(1)]	6,00,000	
Loss brought forward (₹ 12 lakhs) or unabsorbed depreciation (₹ 10 lakhs) as per books, whichever is less	10,00,000	39,00,000
Book Profit for computation of MAT under section 115JB		**68,00,000**

Computation of Minimum Alternate Tax (MAT) under section 115JB

Particulars	₹	₹
18.50% of book profit (18.5% of ₹ 68 lakh)		12,58,000
Add: Education cess @ 2%	25,160	
Secondary and higher education cess @ 1%	12,580	37,740
Minimum Alternate Tax payable under section 115JB		**12,95,740**

Note - *Explanation 1* to section 115JB does not require adjustment of interest not paid before due date of filing return of income, while computing book profit. Also, no adjustment is required in respect of eligible depreciation allowable under the Income-tax Act for computing book profit under section 115JB.

Question 28

S. Ltd., engaged in the business of manufacturing, shows a net profit of ₹ 5 crores for the financial year ended 31-3-2017, after debiting/crediting the following items:

(i) On EPABX and mobile phones (exclusively used for the business purpose) purchased during the year, depreciation amounting to ₹ 18 lacs was claimed at 60% treating them as computers.

(ii) ₹ 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.

(iii) ₹ 25 lacs paid for the higher studies of the director's son abroad, with a stipulation that he would be appointed as a trainee in the company under "apprentice training scheme" where there is no evidence of existence of such scheme.

(iv) Dividend of ₹ 10 lacs received from a foreign company in which this company holds 28% of the nominal value of equity share capital of the company. ₹ 0.25 lac expended towards earning dividend.

(v) A machine in use for the past 7 financial years having WDV amounting to ₹ 1.50 lacs on 01-04-2016 was discarded on the same date i.e. 1st April, 2016. The depreciation on the block at 15% has been provided and charged to profit and loss account for the previous year ended 31st March, 2017. The entire block is used for the purpose of business.

(vi) ₹ 45 lacs were paid on 3rd June, 2016 to a National Laboratory with a stipulation that the said contribution shall be used for the purpose of an approved scientific research programme only.

(vii) Secret commission of ₹ 3 lacs was paid and debited under commission account.

(viii) Purchased a brand new bus for ₹ 15 lacs and donated to a school where the employees' children were studying and debited the same to the Workmen and Staff Welfare Account.

Note: *A debt of ₹ 5 lac was claimed as bad debt in the previous year 2014-15. A sum of Rs.1 lakh was recovered in the P.Y. 2016-17. The amount of recovery is credited to general reserve account.*

Compute total income of S. Ltd. for the Assessment Year 2017-18 and work out the amount of tax payable on such income, indicating reasons for treatment of each item. Ignore provisions relating to minimum alternate tax.

Answer

Computation of total income of S Ltd. for the A.Y. 2017-18

Particulars		₹	₹
Profits and gains of business or profession			
Net profit as per profit and loss account			5,00,00,000
Add:	Excess depreciation provided on EPABX & Mobile phones not allowable as deduction [Note (i)]	13,50,000	
	Payment for higher studies of director's son abroad not allowable as deduction [Note (iii)]	25,00,000	
	Expenditure on earning dividend from foreign company not deductible [Note (iv)]	25,000	
	Bad debt written off earlier recovered now [Note (ix)]	1,00,000	
	Secret commission paid not allowable [Note (vii)]	3,00,000	42,75,000
			5,42,75,000
Less :	Dividend received from foreign company to be considered under the head "Income from other sources" [Note (iv)]	10,00,000	

Payment to National Laboratory eligible for weighted deduction@ 200% under section 35(2AA) [Note (vi)]	45,00,000	
		55,00,000
		4,87,75,000
Income from Other Sources		
Dividend from foreign company [Note (iv)]		10,00,000
Total Income		**4,97,75,000**

Computation of tax liability of S Ltd. for the A.Y.2017-18

Particulars	₹
Tax @15% on dividend from specified foreign company ₹ 10,00,000 [Note (iv)]	1,50,000
Tax @30% on the balance total income of ₹ 4,87,75,000	1,46,32,500
	1,47,82,500
Add: Surcharge@ 7% (since total income exceeds ₹ 1 crore but less than ₹ 10 crore)	10,34,775
	1,58,17,275
Add: Education cess@2%	3,16,345
Secondary and higher education cess@1%	1,58,173
Total tax liability	**1,62,91,793**

Notes:

(i) EPABX and mobile phones are not computers and therefore, are not entitled to depreciation @ 60%. It was so held by the Kerala High Court in *Federal Bank Ltd. v. ACIT (2011) 332 ITR 319*. Therefore, EPABX and mobile phones would be entitled to depreciation of ₹ 4,50,000, calculated by applying the rate of 15%, being the general rate applicable to plant and machinery, on the cost of ₹ 30,00,000 (₹ 18,00,000 × 100/60). The excess depreciation of ₹ 13,50,000 (being ₹ 18,00,000 – ₹ 4,50,000), debited to profit and loss account, should be added back.

(ii) The issue is whether payment of ₹ 5 lakhs to N Ltd. towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset, is allowable as revenue expenditure.

On this issue, 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. In this case, since the feasibility study was conducted by S Ltd. for the existing business and the study was abandoned without creating a new asset, the expenses were of revenue nature.

Since the expenditure of ₹ 5 lakhs has already been debited to profit and loss account, no further adjustment is required.

(iii) In this case, since there is no evidence of existence of any “apprentice training scheme”, the expenditure of ₹ 25 lakhs incurred in respect of higher studies abroad for the 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 S Ltd. It was so held by the Bombay High Court in *Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286*.

(iv) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15% as against the tax rate of 30% applicable to other income of a domestic company. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of ₹ 10 lakhs received by S Ltd. from a foreign company, in which it holds 28% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head “Income from other sources”. No deduction is allowable in respect of ₹ 0.25 lakhs expended on earning this income.

Since such dividend has been credited to the profit and loss account, the same has to be reduced for computing income under the head “Profits and gains of business or profession. Likewise, ₹ 0.25 lakhs, representing expenditure for earning dividend income, which has been debited to profit and loss account, should be added back for computing business income.

(v) The issue under consideration is whether depreciation is allowable on the written down value of the entire block, even though the block includes some machinery which has already been discarded and hence, cannot be put to use during the relevant previous year.

The expression "used for the purposes of the business" in section 32, when used with respect to discarded machinery, would mean the use in the business, not in the relevant financial year, but in the earlier financial years. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it is used in the earlier previous years for the business. It was so held by the Delhi High Court in *CIT vs. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297*.

Since the depreciation, in this case, has been debited to profit and loss account, no further adjustment is required.

(vi) Under section 35(2AA), weighted deduction@200% is allowable in respect of amount paid to a National Laboratory with a specific direction that such sum shall be used for the purpose of an approved scientific research programme. Therefore, in this case, deduction of ₹ 90 lakhs (i.e., 200% of ₹ 45 lakhs) is allowable to S Ltd under section 35(2AA). Since only the actual payment of ₹ 45 lakhs has been debited to profit and loss account, the balance of ₹ 45 lakhs has to be deducted[6].

(vii) 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. It was so held in *Tarini Tarpauline Productions v. CIT (2002) 254 ITR 495 (Ori.)*.

(viii) 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 S Ltd. 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). It was so held by the Rajasthan High Court in *CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408*.

(ix) The amount of bad debt written off earlier when recovered subsequently, such recovery is taxable under section 41(4).

Question 29

XYZ Private Limited is engaged in manufacture and sale of ceramic tiles. The net profit of the company as per its profit and loss account for the year ended 31st March, 2017 is ₹ 150 lakh after debiting or crediting the following items:

(i) One-time license fee of ₹ 20 lakh paid to People Ltd (an Indian company) for obtaining franchise on 1st June, 2016.

(ii) ₹ 29,000 paid to A & Co., a goods transport operator, in cash on 31st January, 2017 for carrying company's products to the warehouse.

(iii) Rent of ₹ 6 lakh received from letting out a part of its office premises. Municipal tax in respect of the said part of the building is ₹ 15,000 remains unpaid due to court litigation.

(iv) ₹ 2 lakh, being contribution to a University approved and notified under section 35(1)(ii).

(v) ₹ 3 lakh, being loss due to destruction of a machinery caused by a fire due to short circuit. The Insurance Company did not admit the claim of the company.

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[6] W.e.f. AY 2018-19 the deduction shall be @ 150% and from AY 2021-22 it shall be 100% i.e. no weighted deduction shall be allowed].

(vi) ₹ 5 lakh paid to a contractor for repair work at the company's factory. No tax was deducted on such payment.

(vii) Dividend of ₹ 0.10 lakh from P. Limited on 1000 equity shares of ₹ 10 each purchased at ₹ 100 per share on 10th October, 2016. The rate of dividend declared is 100%, the record date being 10th December, 2016. The shares were sold on 1st March, 2017 at ₹ 80 per share. Loss of ₹ 0.20 lakh has been debited to Profit & Loss Account.

(viii) Depreciation on tangible fixed assets ₹ 1.10 lakh.

Additional Information:

(i) Depreciation on tangible fixed assets as per Income-tax Rules ₹ 1.75 lakh.

(ii) The company has obtained a loan of ₹ 2 lakh from ABC Private Limited in which it holds 16% voting rights. The accumulated profits held by ABC Private Limited on the date of loan was ₹ 0.50 lakh.

Compute total income of XYZ Private Limited for the Assessment Year 2017-18 indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

Answer

Computation of total income of XYZ Private Ltd. for the A.Y. 2017-18

Particulars	₹	₹
Income from House Property (Note 1)		
Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information)	6,00,000	
Less: Municipal Taxes (not deductible since it has not been paid)	Nil	
Net Annual Value (NAV)	6,00,000	
Less: Deduction under section 24 (30% of NAV)	1,80,000	4,20,000
Profits and gains of business or profession		
Net profit as per profit and loss account	1,50,00,000	
Add: Licence fee for obtaining franchise **(Note 2)**	20,00,000	
Municipal taxes in respect of let-out part of office premises **(Note 1)**	15,000	
Contribution to approved and notified university (treated separately) **(Note 4)**	2,00,000	
Loss due to destruction of machinery by fire **(Note 5)**	3,00,000	
Amount paid to contractor without deduction of tax at source @ 30% of Rs.5 lakhs **(Note 6)**	1,50,000	
Short-term capital loss on sale of shares of P. Ltd. **(Note 7)**	20,000	

	Depreciation on tangible fixed assets **(Note 8)**		1,10,000	
			1,77,95,000	
Less:	Depreciation under section 32 **(Note 8)**			
	Tangible fixed assets **(Note 8)**	1,75,000		
	Intangible asset (Franchise) 25% of ₹ 20,00,000 **(Note 2)**	5,00,000	6,75,000	
	Weighted deduction under section 35(1)(ii) **(Note 4)**			
	₹ 2,00,000 x 175% (Contribution of University)		3,50,000	
	Rental income to be taxed under "Income from house property" **(Note 1)**		6,00,000	
	Dividend credited to profit and loss account to be excluded **(Note 7)**		10,000	
				1,61,60,000
Capital Gains (Note 7)				
Short-term capital loss (₹ 20 x 1000 shares)			20,000	
Less:	Dividend exempt under section 10(34)		10,000	
Short-term capital loss to be carried forward to A.Y. 2018-19			10,000	
Income from Other Sources (Note 9)				
Deemed dividend under section 2(22)(e)				50,000
Total Income				**1,62,10,000**

Notes:

(1) Rental income from letting out a part of the office premises is taxable under "Income from house property". Therefore, it has to be deducted while calculating business income, since the income has been credited to profit and loss account. Likewise, municipal taxes due in respect of such property, debited to profit and loss account has to be added back to compute business income

Note *- There is an alternate view that rental income from letting out part of the excess premises by an assessee who is engaged in business is only exploitation of the commercial asset by an assessee who is engaged in business and hence, the same constitutes business income only. In such a case also, municipal taxes is not allowable as deduction since the same has not been paid on or before the due date of filing of return of income as required under section 43B.*

(2) Franchise is an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 20 lakh paid for obtaining franchise has been debited to profit and loss account,

the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset since it has been used for more than 180 days during the year.

(3) ₹ 29,000 paid to A & Co., a goods transport operator in cash is deductible while computing business income, as the limit for disallowance under section 40A(3) would be attracted in case of payment to a transport contractor only when it exceeds Rs.35,000. Since it is already debited to profit and loss account, no further adjustment is required.

(4) Contribution to a university approved and notified under section 35(1)(ii) is eligible for a weighted deduction of 175%. Therefore, the contribution of ₹ 2,00,000 debited to profit and loss account has been added back and ₹ 3,50,000 (being 175% of ₹ 2,00,000) has been deducted while computing business income[7].

(5) Loss of ₹ 3 lakh due to destruction of machinery caused by fire is not deductible since it is capital in nature.

(6) Payment to contractor would attract disallowance at 30% of the expenditure.

(7) As per section 94(7), where any person buys any shares within 3 months prior to the record date and sells such shares within 3 months after such date and the dividend received on such shares is exempt, then the loss arising out of such purchase and sale of shares shall be ignored to the extent of dividend income.

	₹
Loss on purchase and sale of shares (₹ 100 - ₹ 80) x 1000 shares	20,000
Less: Dividend exempt under section 10(34)	10,000
Short-term capital loss	10,000

Since short term capital loss can be set-off only against income under the head "Capital Gains", the short-term capital loss of ₹ 10,000 has to be carried forward to the next year. Dividend of ₹ 10,000 credited to profit and loss account has to be deducted and short-term capital loss of ₹ 20,000 debited to profit and loss account has to be added back.

(8) Depreciation as per Income-tax Rules, 1962, is deductible while calculating business income. Therefore, ₹ 1.75 lakh depreciation on tangible fixed assets and ₹ 5 lakh on intangible assets is deducted. The amount of ₹ 1 lakh depreciation debited to profit and loss account has been added back.

(9) As per section 2(22)(e), any payment by a company in which the public are not substantially interested by way of loan to a shareholder, who is the beneficial owner of shares holding not less than 10% of voting power, is deemed as dividend to the extent to which to company possesses accumulated profits. Accordingly, in this case, ₹ 50,000 would be deemed as dividend under section 2(22)(e).

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[7] W.e.f. A.Y.2018-19 it is deductible @150% and from A.Y.2021-22 @ 100% i.e. no weighted deduction would be allowed

Question 30

ABC Limited has claimed exemption on the income from long-term capital gains under section 54EC by investing in bonds of National Highway Authority of India within the prescribed time. In the computation of "book profit" under section 115JB, the company claimed exclusion of long-term capital gains because of exemption available on it by virtue of section 54EC. The Assessing Officer reckoned the book profit including long-term capital gains for the purpose of levy of minimum alternate tax payable under section 115JB.

Is the action of the Assessing Officer justified in law?

Answer

The issue under consideration in this case is whether long-term capital gain exempted by virtue of section 54EC can be included in the book profit computed under section 115JB for levy of minimum alternate tax.

It may be noted that minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18.5% of book profit. Chapter XII-B is a self-contained code for computation of book profit. The net profit as per the profit and loss account for the relevant previous year prepared in accordance with Schedule III of the Companies Act, 2013 as increased/reduced by the specified adjustments provided for in *Explanation 1* to section 115JB would be the book profit for levy of MAT under section 115JB. Therefore, if an assessee has claimed exemption under section 54EC by investing in bonds of National Highways Authority of India within the prescribed time, the long term capital gains so exempt would still be taken into account for computing book profit under section 115JB for levy of MAT, since *Explanation 1* to section 115JB does not provide for such deduction.

As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with Schedule III of the Companies Act, 2013 capital gains cannot be excluded unless provided under *Explanation 1* to section 115JB. It was so held by the Kerala High Court in *N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 0132.*

Therefore, the action of the Assessing Officer is justified in law.

Question 31

Aditya, Avirup and Avigyan carried on business of running hotels in partnership from 1st April, 2006 to 31st March, 2015. In order to increase its scale of operation and meet its fund requirement, the firm decided to carry on its business through corporate route. For that purpose, a company under the name and style "Triple A Hospitality Private Limited" was formed on 1st April, 2015 and the business of the partnership firm as a whole was succeeded to by the company with effect from 1st June, 2015.

The company's profit and loss account for the year ended 31st March, 2017 shows a net profit of ₹ 450 lacs after debit/credit of the following items:

(a) Interest of ₹ 3 lacs paid to Allahabad Bank on a term loan taken for the purpose of acquiring a land at Bhubaneswar for a new hotel to be set up.

(b) Depreciation charged ₹ 40 lacs.

(c) ₹ 2 lacs credited on account of waiver of dues obtained from a supplier of the erstwhile firm against supply of certain raw materials.

(d) ₹ 1.18 lacs being the aggregate of amounts paid in cash to Rajaram, a transport contractor as follows:

Date of Payment	***₹ (In lacs)***
5th June, 2016	*0.15*
20th July, 2016	*0.21*
20th September, 2016	*0.22*
3rd November, 2016	*0.26*
5th November, 2016	*0.36*

Tax was not deducted at source from the above payments. Mr. Rajaram has furnished a declaration to the company.

(e) Provision for bad and doubtful debts ₹ 12 lacs.

(f) Payment of ₹ 25 lacs to some employees as compensation for voluntary retirement, as per scheme.

Other Information:

(i) Depreciation as per the Income-tax Act, 1961 ₹ 65 lacs.

(ii) Debt of ₹ 4 lacs due from one corporate customer for three months has been written off during the year after giving a few reminders by debiting provision for bad and doubtful debts account.

(iv) The erstwhile firm was allowed exemption of ₹ 50 lacs under section 47(xiii) in respect of long-term capital assets transferred to the company.

(v) The company's voting rights till 31st March, 2016 were held as follows:

Aditya	*40%*
Avirup	*30%*
Avigyan	*15%*
Others	*15%*

During the P.Y 2016-17, shares constituting 36% of voting rights were sold by Aditya to his son-in-law, Avishek.

(vi) Unabsorbed business loss and unabsorbed depreciation of ₹ 10 lacs each have been carried forward from Assessment Year 2015-16.

(vii) The company has a subsidiary company, Tours & Travels Private Limited (a closely held company). During the year, the company obtained a temporary loan of ₹ 12 lacs from its subsidiary company. Accumulated profit of the subsidiary company was ₹ 30 lacs at the time of payment of the loan. The loan was repaid by the company before the end of the year.

Compute total income of Triple A Hospitality Private Limited for the Assessment Year 2017-18. Indicate reasons for treatment of each of the items. Ignore the provisions relating to minimum alternate tax.

Answer

Computation of Total Income of Triple A Hospitality (P) Ltd. for the A.Y.2017-18

Particulars	₹	
A. Profits and Gains from Business and Profession		
Net Profit as per Profit & Loss Account		4,50,00,000
Add: **Items debited but to be considered separately or to be disallowed**		
Interest on loan taken for acquiring land **(Note 1)**	3,00,000	
Depreciation debited in accounts	40,00,000	
Disallowance for payment exceeding the limit prescribed in section 40A(3) **(Note 3)**	36,000	
Provisions for bad and doubtful debts **(Note 4)**	12,00,000	
Compensation for voluntary retirement **(Note 5)**	20,00,000	75,36,000
		5,25,36,000
Less: **Items credited but to be considered separately or to be allowed**		
Depreciation allowable under the Income-tax Act, 1961	65,00,000	
Bad debts written off under section 36(1)(vii) **(Note 4)**	4,00,000	69,00,000
Business Income		**4,56,36,000**
B. Capital Gains		
Deemed long-term capital gain under section 47A(3) **(Note 6)**		50,00,000
C. Income from other sources		
Deemed dividend under section 2(22)(e) **(Note 7)**		12,00,000
Gross Total Income		**5,18,36,000**
Deduction under Chapter VI-A		Nil
Total Income		**5,18,36,000**

Notes:

(1) Interest on term loan taken from bank for acquiring land for new hotel to be set up is not allowable under section 36(1)(iii). As per the proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for the period from the date on which the borrowing was made till the date on which such asset is first put to use shall not be allowed as deduction.

(2) Under section 41(1), where any expenditure or loss or a trading liability was allowed as deduction to the predecessor-firm and the successor in business has obtained (in cash or in any other manner), any amount in respect of which loss or expenditure was incurred by the predecessor-firm or some benefit by way of remission or cessation of such trading liability, the amount obtained by the successor in business (the company, in this case) or the value of benefit accruing to the successor shall be deemed to be profits and gains of business or profession and would be chargeable to tax in the year in which the amount is so obtained or the benefit accrued. In view of this provision, the amount of waiver i.e. ₹ 2,00,000 obtained from the supplier of the predecessor firm is deemed as business income of the assessee company. Since the amount is already credited to profit & loss account, no adjustment is necessary.

(3) Section 40A(3) provides that where the assessee incurs any expenditure for which a payment or aggregate of payments made to a person in a single day, otherwise than by account payee cheque or account payee bank draft exceeds ₹ 20,000, the whole of such expenditure shall be disallowed. **However, for payment to transport operators for plying, hiring or leasing goods carriage, the limit for attracting disallowance under section 40A(3) is ₹ 35,000.** Therefore, payment or aggregate payments up to ₹ 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft without attracting disallowance under section 40A(3). Therefore, the amount to be disallowed is ₹ 36,000 being the payment made on 5th November, 2016.

Disallowance under section 40(a)(ia) for non deduction of tax at source under section 194C, to the extent of 30% of the amount paid is not attracted, since Rajaram has furnished declaration to the company.

(4) Provision for bad and doubtful debts is allowable as deduction under section 36(1)(viia) only in the case of specified banks and financial institutions. Therefore, a company engaged in hotel business is not eligible for deduction in respect of provision for bad and doubtful debts and accordingly, ₹ 12 lacs, debited to profit and loss account has to be added back.

A bad debt written off is allowed as deduction under section 36(1)(vii) if such debt is written off as irrecoverable in the books of account. Bad debts may be written off by debiting profit & loss account or provision for bad and doubtful debts account.

Therefore, the amount of ₹ 4 lacs written off during the year by debiting provision for bad and doubtful debts is allowable as deduction under section 36(1)(vii).

(5) As per section 35DDA, where in any previous year, any expenditure is incurred by way of payment of any sum to an employee in connection with voluntary retirement, one-fifth of the amount so paid shall be deducted in computing profits and gains of business for that previous year, and the balance shall be deducted in four equal instalments in the immediately succeeding four previous years. Therefore, out of ₹ 25,00,000, an amount of ₹ 5,00,000 is deductible in assessment year 2017-18 and the balance shall be disallowed in this assessment year. Therefore, ₹ 20 lacs has to be added back.

(6) It is stated that the erstwhile firm was allowed exemption under section 47(xiii) in respect of long-term capital gain from transfer of capital assets to the assessee company. One of the conditions as per the proviso to clause (xiii) of section 47 is that the aggregate of the shareholding in the company of the partners of the firm is at least 50% of the total voting power in the company and their shareholding continues to be as such for 5 years from the date of succession.

According to section 47A(3), where any of the conditions laid down in the proviso to clause (xiii) of section 47 are not complied with, the capital gain which was not charged to tax under section 45 shall be chargeable to tax in the hands of the successor company for the previous year in which the requirements of the proviso to clause (xiii) of section 47 are not complied with.

In the instant case, on sale of shares carrying 36% voting rights by Aditya to his son-in-law, the aggregate of shareholding of the partners in the company has become less than 50% of the total voting power in the company and such change has taken place before expiry of 5 years from the date of succession. Therefore, the long-term capital gain which was not charged to tax in the hands of the firm in the year of succession shall be deemed to be long-term capital gain of the assessee company in the assessment year 2017-18.

(7) Section 2(22)(e) provides that dividend includes any payment to the extent of accumulated profits by a company, in which the public are not substantially interested, of any sum by way of loan or advance to a shareholder who holds the beneficial ownership of equity shares carrying not less than 10% of the voting power.

In the instant case, the assessee company having more than 10% voting power in Tours & Travel Private Limited (a closely held company) received loan of ₹ 12 lacs from the latter which had an accumulated profit of ₹ 30 lacs. Therefore, the amount of loan shall be deemed to be dividend in the hands of the assessee company. The fact that the loan was repaid before end of the previous year is not relevant.

The amount deemed to be dividend under section 2(22)(e) is not exempt under section 10(34).

(8) Since the unabsorbed business loss and unabsorbed depreciation relate to A.Y.2015-16, which is prior to incorporation of the company on 1.4.2015, such loss and depreciation would relate to the predecessor firm, and consequently, the provisions of section 72A(6) would be attracted.

As per section 72A(6), accumulated loss and depreciation of the predecessor firm would become the loss and depreciation of the successor company of the previous year in which the conversion takes place (i.e., P.Y.2015-16, in this case), provided the conditions laid down in section 47(xiii) are fulfilled. In this case, the conditions are fulfilled in the P.Y.2015-16. It appears that the assessee-company did not have sufficient profits during the P.Y.2015-16, against which the brought forward loss and unabsorbed depreciation can be set-off and for this reason, the same has been carried forward to the P.Y.2016-17 (A.Y.2017-18).

However, in the P.Y.2016-17, one of the conditions as per the proviso to clause (xiii) of section 47 is not satisfied, namely, the condition requiring the aggregate of the shareholding in the company of the partners of the firm to be at least 50% of the voting power in the company and to continue to remain as such for 5 years from the date of succession. Therefore, since in the P.Y.2016-17, this condition is not satisfied on account of sale of shares by Aditya to Avishek, and consequent reduction in the holding from 85% to 49%, the business loss and unabsorbed depreciation cannot be set-off.

Question 32

Examine the following statements in the context of the provisions contained in the various Chapters of the Income-tax Act, 1961:

(i) "The provisions of section 115JB are not applicable in the case of foreign companies".

(ii) "The provisions of dividend distribution tax are also applicable to an undertaking or enterprise engaged in developing, operating and maintaining a Special Economic Zone (SEZ)".

Answer

(i) The Finance Act, 2016 has inserted *Explanation 4* to section 115JB with retrospective effect from 1.4.2001 to provide for non-applicability of levy of MAT under section 115JB on foreign companies subject to satisfaction of certain conditions:

(i) Where the foreign company is a resident of a country or a specified territory with which India has a DTAA under section 90(1) or the Central Government has adopted any agreement between specified associations for double taxation relief under section 90A(1), it should not have a permanent establishment in India in accordance with the provisions of such Agreement;

(ii) Where the foreign company is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) above, it should not be required to seek registration under any law for the time being in force relating to companies.

The provisions of MAT under section 115JB would not be attracted in case of such foreign companies satisfying these conditions.

Further, in the case of any foreign company (not satisfying the above conditions for non-applicability of MAT), the amount of income accruing or arising from –

(A) the capital gains arising on transactions in securities; or

(B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,

if such income is credited to profit and loss account and the income-tax payable thereon in accordance with the provisions of this Act, other than the provisions of Chapter XII-B, is at a rate less than the rate of 18.5%,

shall be reduced while computing book profit.

Consequently, the amount of expenditure relating to the above said income, if debited to profit and loss account, shall be added back for computing the book profit for levy of MAT under section 115JB.

Thus, since the non-applicability of MAT is either subject to fulfilment of the prescribed conditions, and in other cases (i.e., cases where MAT is applicable), non-applicability is restricted to only specified income, the statement that the provisions of section 115JB are not applicable in the case of foreign companies is only partially correct.

(ii) The statement is correct.

The Finance Act, 2011 has introduced a sunset clause to remove the exemption in respect of dividend distribution tax in case of an undertaking or an enterprise engaged in developing, operating and maintaining an SEZ for dividends declared, distributed or paid on or after 1st June, 2011. Therefore, the statement given in the question is correct in respect of dividend declared, distributed or paid on or after 1st June, 2011.

Question 33

The net profit of ABP Ltd. as per Profit & Loss Account for the previous year 2016-17 is ₹ 100 lacs after debiting/crediting the following items:

(i) Provision for income-tax : ₹ 15 lacs

(ii) Provision for deferred tax : ₹ 8 lacs

(iii) Proposed Dividend : ₹ 20 lacs

(iv) Depreciation debited to Profit & Loss Account is ₹ 12 lacs. This includes depreciation on revaluation of asset to the tune of ₹ 2 lacs.

(v) Profit from unit established in Special Economic Zone : ₹ 30 lacs

(vi) Provision for permanent diminution in value of investments : ₹ 2 lacs

Brought forward losses and unabsorbed depreciation as per books of the company are as follows:

Previous year	*Brought forward loss (₹ in lacs)*	*Unabsorbed Depreciation (₹ in lacs)*
2013-14	*2*	*5*
2014-15	*-*	*3*
2015-16	*10*	*2*

Compute book profit of the company under section 115JB for Assessment Year 2017-18.

Answer

Computation of book profit of ABP Ltd. under section 115JB for A.Y. 2017-18

Particulars	₹ (in lacs)	
Net profit as per profit and loss account		100

Add: **Net profit to be increased by the following amounts as per *Explanation 1* to section 115JB**		
Provision for income tax	15	
Provision for deferred tax	8	
Proposed dividend	20	
Depreciation	12	
Provision for diminution in value of investment	2	57
		157
Less: **Net profit to be reduced by the following amounts as per *Explanation 1* to section 115JB**		
Depreciation (excluding depreciation on revaluation of assets)	10	
Lower of brought forward loss or unabsorbed depreciation, as per books (on overall basis)	10	20
Book Profit		**137**

Note - *A sunset clause has been inserted by the Finance Act, 2011 to remove MAT exemption to SEZ units and developers with effect from A.Y. 2012-13. Therefore, profit from unit established in SEZ cannot be excluded for computation of book profit.*

Question 34

ABC (P) Ltd. made a provision of ₹ 30 lacs for doubtful debts by debit to profit and loss account. The Assessing Officer, while computing book profit under section 115JB, wants to add back the provision. Is the Assessing Officer justified in making such addition for computing book profit?

Answer

Explanation 1 below section 115JB(2) has been amended to provides that the net profit should be increased by, *inter alia*, the amount set aside as provision for diminution in the value of any asset, if the same has been debited to profit and loss account, for computing the book profit.

Therefore, the Assessing Officer is justified in adding back the provision of ₹ 30 lacs for doubtful debts while computing book profit.

Question 35

Yaman Limited is a company in which 60% of the shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to ₹ 35 lacs to its shareholders for the financial year 2015-16 in its Annual General Meeting held on 10th July, 2016. Dividend distribution tax was paid by Yaman Limited on 21st July, 2016. Piloo Limited declared an interim dividend amounting to ₹ 50 lacs on 15th October, 2016.

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

Answer

As per section 115-O, dividend distribution tax at the rate of 17.304% (i.e., 15% plus surcharge @12%, education cess@2% and secondary and higher education cess@1%) is leviable on dividend declared, distributed or paid by a domestic company. As per section 115-O(1A), a holding company receiving dividend from its domestic subsidiary company can reduce the same from dividend declared, distributed or paid by it. The dividend from its domestic subsidiary company should be received in the same financial year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

(1) The domestic subsidiary company should have paid the dividend distribution tax which is payable on such dividend;

(2) The recipient holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

Section 115-O (1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be computed as follows:

Particulars	₹ in lakh
Dividend distributed by Piloo Ltd.	50.00
Less: Dividend received from subsidiary Yaman Ltd. (60% of ₹ 35 lacs)	21.00
Net distributed profits	**29.00**
Add: Increase for the purpose of grossing up of dividend 29 X 100 /85 = 34.12 minus 29.00	5.12
Gross dividend	**34.12**
Additional income-tax payable by Piloo Ltd. u/s 115-O [15% of ₹ 34.12 lakh]	5.12
Add: Surcharge@12%	0.61
	5.73
Add: Education cess@2% and SHEC@1%	0.17
	5.90

In order to remove the cascading effect of DDT in a multi-tier corporate structure, section 115-O was amended by the Finance Act, 2012. Accordingly, in case any domestic company (Piloo Ltd., in this case) receives any dividend during the year from any subsidiary company (Yaman Ltd., in this case) and such subsidiary company (Yaman Ltd.) has paid the DDT as payable on such dividend, then, dividend distributed by the holding company (Piloo Ltd.,) in the same year to the extent of dividend received from the subsidiary (Yaman Ltd.), shall not be subject to DDT under section 115-O, irrespective of whether the holding company (Piloo Ltd.) is a subsidiary of any other company (Kafi Ltd., in this case).

Therefore, in spite of the fact that Piloo Ltd. is a subsidiary of Kafi Ltd., it can reduce the amount of dividend received from Yaman Ltd. for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 17.304% of ₹ 34.12 lacs (grossed up amount) i.e. ₹ 5.90 lacs.

Question 36

The net profit of ABC Ltd. for the year ended 31.03.2017 amounted to ₹ 7,22,000 after debiting/crediting following items:

(i) Payment of interest on money borrowed from bank for purchase of land ₹ 2,22,000. The land was meant for construction of a factory building and for which the approval from local authority is pending till 31.03.2017.

(ii) Commission ₹ 1,00,000 paid in the month of February, 2017 and ₹ 1,25,000 paid in March, 2017. Tax deducted at source from the payments was deposited to the Government on 28.09.2017.

(iii) Travelling expenses of ₹ 90,000 on a foreign tour of a director for negotiating collaboration with a foreign manufacturer for initiation of new line of business.

(iv) Securities transaction tax paid ₹ 10,000. Income from trading in shares already credited to profit and loss account ₹ 3,82,000.

(v) As part of the restructuring of its debt, the company has converted arrears of interest of ₹ 3,00,000 on term loan into a new term loan with a revised repayment schedule. The company has paid ₹ 50,000 towards such funded interest during the year..

(vi) ₹ 5,00,000, being contribution to S Ltd. (wholly owned subsidiary company) for construction of a school for the benefit of its employees.

(vii) Provision for gratuity based on actuarial valuation ₹ 6,00,000 was debited to profit and loss account. Actual gratuity paid ₹ 1,50,000 was debited to provision for gratuity account.

Other information:

(1) Provision for bonus for the year 2015-16 paid on 15.11.2016 ₹ 98,000. It is inclusive of payment by bearer cheque of ₹ 34,000 to one employee.

(2) The company has purchased and put to use a commercial vehicle of ₹ 8,00,000 for the purpose of business on 21.03.2017 and calculated depreciation@15% for the full year.

Depreciation debited to the profit and loss account is calculated on all other assets as per the rates prescribed in the Income-tax Act, 1961.

(3) *The company collected ₹ 3,00,000 from its customers towards sales tax in the year 2012-13 and remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the levy as illegal and the State Government refunded the amount to the company in April, 2016. The company refunded ₹ 2,00,000 to the customers and the remaining amount of ₹ 1,00,000 was shown under the head "current liabilities".*

Compute the income chargeable to tax in assessment year 2017-18, ignoring the provisions of section 115JB.

Answer

Computation of total income and tax liability of ABC Ltd. for A.Y.2017-18

Particulars	₹	₹
Profits & Gains of Business of Profession		
Net Profit as per Profit & Loss Account		7,22,000
Add: **Items debited but to be considered separately or to be disallowed**		
Commission paid in February, 2017 and March 2017, after deduction of tax and TDS from such payments remitted before the due date for filing the return of income. Hence, allowed **(Note 2)**	Nil	
Travelling expenses on foreign tour in connection with new line of business **(Note 3)**	90,000	
Interest on money borrowed for purchase of land to be capitalised as per section 36(1)(iii) **(Note 1)**	2,22,000	
Interest on term loan converted into new term loan **(Note 5)**	2,50,000	
Provision for gratuity ₹ 6,00,000		
Less: Gratuity paid ₹ 1,50,000 **(Note 7)**	4,50,000	
Depreciation on commercial vehicle **(Note 9)**	60,000	
Sales tax refund not returned to the customers **(Note 10)**	1,00,000	11,72,000
		18,94,000
Less: **Items credited but to be considered separately and those not charged but to be allowed**		
Bonus paid on 15.11.2016 in respect of previous year 2015-16 disallowed last year but allowable now **(Note 8)**		64,000
Business Income		**18,30,000**
Deduction under Chapter VI-A		Nil
Total Income		**18,30,000**

Notes:

(1) As per section 36(1)(iii), interest on borrowed capital till the asset is put to use has to be capitalized. Hence, interest on moneys borrowed is not allowable under section 36(1)(iii).

(2) As per section 40(a)(ia), tax deducted and remitted in respect of commission paid in the months of February and March 2017 is deductible since the TDS was remitted on 28.09.2017 being the date before the due date meant for filing return of income.

(3) Travelling expenses incurred on foreign tour of a director for initiating a new line of business is a capital expenditure. The same is, therefore, not deductible under section 37(1).

(4) Securities transaction tax is allowable as deduction under section 36(1)(xv) if the income arising from taxable securities transaction is included in computing the income under the head "Profits and gains of business or profession". As income from trading in shares is included in computation of business income, securities transaction tax of ₹ 10,000 is allowable as deduction. It is assumed that the company is into the business of trading of shares. Hence the income generated from trading in shares is not speculative income.

(5) As per section 43B, any sum payable by the assessee as interest on any loan or borrowing from, *inter alia*, any public financial institution or scheduled bank shall be allowed only in computing the income of that previous year in which sum is actually paid. In respect of the previous year in which the liability to pay such sum was incurred, deduction will also be allowed in relation to the sum or part thereof which is paid on or before the due date of filing of return for that year. As per *Explanations 3C and 3D* below section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution or scheduled bank shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

The manner in which the converted interest will be allowed as deduction has been clarified vide *Circular No.7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the financial institution or scheduled bank, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Accordingly, out of ₹ 3 lacs, only ₹ 50,000, being the funded interest was actually paid which is allowable as deduction while computing business income of P.Y.2016-17. The balance of Rs.2,50,000 is added back.

(6) Contribution to a wholly owned subsidiary company for construction of a school for the benefit of its employees is allowable under section 37(1).

(7) Under section 40A(7), no deduction is allowed in respect of any provision made for the payment of gratuity to the employees on retirement or termination of employment for any reason. However, gratuity actually paid is admissible as deduction. Therefore, provision for gratuity of ₹ 6,00,000 is to be disallowed. Actual gratuity paid ₹ 1,50,000 debited to

provision for gratuity account is allowable. Hence, only the net sum of ₹ 4,50,000 has to be added back.

(8) As per section 40A(3), expenditure in respect of which payment is made in a day in a sum exceeding ₹ 20,000 otherwise than by account payee cheque or account payee bank draft is disallowed. In this case, provision for bonus for the previous year 2015-16 would have been disallowed under section 43B for non-payment by due date for filing of return of income for assessment year 2016-17. Payment of bonus made after the said date is allowed in the year of actual payment. However, such deduction allowable in the year of payment is subject to the provisions of section 40A(3). Hence, the sum of ₹ 34,000 being bonus paid by bearer cheque shall not be allowed as deduction in the year of payment. Assuming that the balance amount of ₹ 64,000 (i.e., ₹ 98,000 – ₹ 34,000) is paid by account payee cheque or account payee bank draft, it is admissible as deduction in the A.Y. 2017-18.

(9) Depreciation on commercial vehicle has been calculated @15% and, consequently, ₹ 1,20,000 has been debited to profit and loss account. Since it was acquired in March 2016 only, 50% of normal depreciation is allowable. The excess depreciation of ₹ 60,000 is hence disallowed.

(10) Sales tax collected by the assessee is to be treated as a trading receipt of the assessee as held by the Supreme Court in the case of *Chowringhee Sales Bureau Private Limited v. CIT (1973) 87 ITR 542 (SC)*. Sales tax paid by the assessee is to be deducted from its profits. If any deduction is so allowed and subsequently the sales tax is refunded by the Government, the refund so made has the character of a revenue receipt. Therefore, the amount is taxable as deemed income under section 41(1). However, the assessee is entitled to claim deduction of the amount of refund of sales tax as and when the same is refunded by the assessee to the purchaser. This view finds support from *CIT v. Thirumalaiswamy Naidu and Sons v. CIT (1998) 230 ITR 534 (SC)*. In view of this, the amount not yet refunded to the customers is taxable. Accordingly, the sum of ₹ 1,00,000, being sales tax not refunded to the customers, is added back.

Question 37

Laxmi Tea Limited is engaged in growing and manufacturing tea in Assam and West Bengal. The company's profit and loss account for the year ended 31st March, 2017 shows a net profit of ₹ 550 lacs after debiting or crediting the following amounts:

(a) Depreciation ₹ 40 lacs.

(b) Interest of ₹ 2 lacs on term loan paid to a bank for purchase of machinery for one of its tea factories.

(c) Repairs to factory building amounting to ₹ 15 lacs for which a sum of ₹ 10 lacs was withdrawn from Tea Deposit account maintained with National Bank for Agricultural and Rural Development (NABARD) as per section 33AB of the Income-tax Act, 1961.

(d) Profit from sale of green tea leaves plucked in own gardens ₹ 20 lacs.

(e) ₹ 5 lacs spent towards stamp duty and registration fees for the issue of bonus shares.

(f) ₹ 5 lacs written off as bad in respect of a trade debt transferred from Saraswati Tea Limited in previous year 2014-15 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.

(g) ₹ 2 lacs contributed to Employees' Welfare Trust.

(h) Interest paid on inter-corporate deposit ₹ 1 lac and ₹ 1.50 lacs for February, 2017 and March, 2017, respectively, for which tax was not deducted at source during the year.

Following additional information are furnished by the management:

(i) Depreciation as per Tax Audit Report under section 44AB ₹ 55 lacs.

(ii) One financial institution converted arrear interest of ₹ 10 lacs into a new loan in financial year 2013-14, which is repayable in five annual instalments. The company has paid ₹ 2 lacs towards the instalment due for the financial year 2016-17 in February, 2017.

(iii) A sum of ₹ 200 lacs was deposited in NABARD on 15th June, 2017 as per the provision of Section 33AB.

(iv) ₹ 10 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.

Compute total income of the company for the Assessment Year 2017-18 stating the reasons for each item. Ignore provision relating to Minimum Alternate Tax.

Answer

Computation of total income of Laxmi Tea Ltd. for the A.Y.2017-18

Particulars	**₹**	
Profit and Gain from Business and Profession		
Net profit as per Profit & Loss Account		5,50,00,000
Add: **Items debited but to be considered separately or to be disallowed**		
Depreciation as per accounts	40,00,000	
Repairs to factory building to the extent of amount spent by withdrawal from Tea Deposit Account **(Note 2)**	10,00,000	
Contribution to Employees' Welfare Trust disallowed under section 40A(9) **(Note 6)**	2,00,000	
Interest paid on inter-corporate deposit for February, 2017 and March 2017 for which tax was not deducted at source disallowed under section 40(a)(ia) at 30% **(Note 7)**	75,000	52,75,000
		6,02,75,000

Less: **Amount credited to profit & loss account but not chargeable to tax**		
Profit on sale of green tea leaves plucked in own gardens is agricultural income and the same is exempt under section 10(1)		20,00,000
		5,82,75,000
Less: **Deductions allowable while computing business income**		
Depreciation as per Income-tax Rules	55,00,000	
Payment of new loan converted from arrear interest **(Note 8)**	2,00,000	57,00,000
		5,25,75,000
Deduction under section 33AB for making deposit in an account with NABARD as per scheme approved by the Tea Board, being lower of the following two amounts:		
Amount deposited	2,00,00,000	
40% of the profit from business of growing and manufacturing tea computed under the head "profits and gains from business and profession" before making this deduction (₹ 5,25,75,000 x 40%)	2,10,30,000	2,00,00,000
		3,25,75,000
Less: 60% of above, being agricultural income as per Rule 8		1,95,45,000
Business income		1,30,30,000
Gross Total Income		**1,30,30,000**
Less: Deduction under Chapter VI-A		Nil
Total Income		**1,30,30,000**

Notes:

1. As per section 36(1)(iii), interest paid in respect of capital borrowed for the purpose of business or profession is allowed as deduction. The term loan was taken for purchasing machinery for use in a tea factory. Thus, the term loan was used for the purpose of business. Hence, interest on term loan is allowable as deduction. As interest has already been debited to the profit and loss account, no adjustment is required. It is assumed that the machinery was put to use immediately after acquisition and hence capitalization of interest is not required.

2. As per section 33AB(6), where any amount standing to the credit of the assessee in the account maintained with NABARD is utilized by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme approved by the Tea Board, such expenditure shall not be allowed as deduction. Therefore, the amount of ₹ 10 lacs withdrawn and utilized for incurring expenditure on repair to factory building is to be disallowed.

3. The Supreme Court, in the case of *CIT vs. General Insurance Corporation (2006) 286 ITR 232,* observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is only reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. The company has not acquired any benefit of enduring nature. There is no increase in capital base of the company**.** Therefore, stamp duty and registration fee in connection with issue of bonus shares is allowable as revenue expenditure under section 37(1).

4. According to section 43B, any tax, duty, cess or fee (by whatever name called) is allowed as deduction if they are actually paid on or before the due date of filing return of income under section 139(1) irrespective of the method of accounting followed by the assessee.

   In the case of *CIT vs. Udaipur Distillery Company Limited (2004) 268 ITR 305 (Raj),* it was held that actual payment requires that amount must flow from the assessee to the public exchequer as specified in section 43B. Mere furnishing of bank guarantee by the assessee towards sales tax dues does not mean actual payment of sales tax dues. Hence, it is not treated as payment to be eligible for deduction under section 43B.

5. Under section 36(1)(vii) read with section 36(2), an assessee can claim deduction in respect of bad debt, provided the amount of such debt has been taken into account in computing total income of the assessee and it is written off in the books of account of the assessee. In the case of *CIT vs. T.Veerabhadra Rao, K.Koteswara Rao & Co. (1985) 155 ITR 152 (SC),* the Apex Court held that the successor of a business is entitled to write off the predecessor's debt as a bad debt and claim deduction if the other conditions are fulfilled. This is so because the benefit of deduction in respect of bad debt is not accrued to the assessee by way of personal relief but relates to the business. Therefore, the assessee company is entitled to deduction under section 36(1)(vii) read with section 36(2) in respect of debt transferred from the amalgamating company, Saraswati Tea Limited.

6. As per section 40A(9), any contribution made by the assessee as an employer to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act or other institution for any purpose shall be disallowed, except where such contribution is paid to a recognised provident fund or approved superannuation fund or approved gratuity fund. Therefore, contribution to the Employees' Welfare Trust is to be disallowed.

7. Section 40(a)(ia) seeks to disallow 30% of any sum paid to any resident, if tax is not deducted at source or, after deduction, tax is not deposited to the Central Government on or before the due date prescribed under section 139(1) of the Act. In this case, tax has not been deducted on interest and hence, 30% of the expenditure shall be disallowed.

8. As per *Explanation 3C* below section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

   The manner in which the converted interest will be allowed as deduction has been clarified vide *Circular No.7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid. Accordingly, the sum of ₹ 2 lacs, being installment paid in February, 2017 shall be allowed as deduction while computing business income of P.Y.2016-17.

Question 38

The net profit as per the profit and loss account of XYZ Ltd., a resident company, for the year ended 31.3.2017 is ₹ 190 lacs arrived at after making the following adjustments:

	Particulars	***₹ (in lacs)***
(i)	*Depreciation on assets*	*100*
(ii)	*Reserve for currency exchange fluctuation*	*50*
(iii)	*Provision for tax*	*40*
(iv)	*Proposed dividend*	*120*

Following further information are also provided by company:

(a) Net profit includes ₹ 10 lacs, being dividend received from an Indian subsidiary company.

(b) Provision for tax includes ₹ 16 lacs of tax payable on distribution of profit and of ₹ 2 lacs of interest payable on income-tax.

(c) Depreciation includes ₹ 40 lacs towards revaluation of assets.

(d) Amount of ₹ 50 lacs credited to P & L account was drawn from revaluation reserve.

(e) Balance of profit and loss account shown in balance sheet at the asset side as at 31.3.2016 was ₹ 30 lacs which includes unabsorbed depreciation of ₹ 10 lakhs.

Compute the income of the company for the year ended 31.3.2017 liable to tax under MAT.

Answer

Computation of income of XYZ Ltd. liable to tax under MAT for the year ended 31.3.2017

Particulars	**₹**	**₹**
Net Profit as per Profit & Loss Account		1,90,00,000
Add: **Net profit to be increased by the following amounts as per *Explanation 1* to section 115JB**		
Depreciation on assets debited to P&L A/c	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back	50,00,000	
Provision for tax **(See Note below)**	40,00,000	

Proposed dividend	1,20,00,000	3,10,00,000
		5,00,00,000
Less: **Net profit to be decreased by the following amounts as per *Explanation 1* to section 115JB**		
Depreciation other than depreciation on revaluation of assets (₹ 100 lacs - ₹ 40 lacs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lacs or ₹ 40 lacs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Unabsorbed depreciation Rs.10 lakhs and brought forward business loss Rs.20 lakhs – whichever is less	10,00,000	
Dividend income [since the same is exempt under section 10(34)]	10,00,000	1,20,00,000
Income liable to tax under MAT		**3,80,00,000**

Note – *For the purpose of section 115JB, book profit means the net profit as per the profit and loss account prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions there for. Explanation 2 after sub-section (2) of section 115JB clarifies that income-tax includes, inter alia, dividend distribution tax / tax on distributed income and interest. Therefore, the entire provision of ₹ 40 lacs for income-tax is added back for computing book profit for levy of MAT.*

Question 39

Hyper Ltd., engaged in diversified activities, earned a net profit of ₹ 14,25,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2017:

(a)	*Items debited to Profit and Loss Account*	*₹*
	Provision for loss of subsidiary	*70,000*
	Provision for sales tax demand (paid before July 2017)	*75,000*
	Provision for income-tax demand	*1,05,000*
	Expenses on purchase/sale of equity shares	*15,000*
	Depreciation	*3,60,000*
	Interest on deposit credited to buyers on 31.3.2017 for advance received from them, on which TDS was deducted in April 2017 and was deposited on 31.7.2017	*1,00,000*
(b)	*Items credited to Profit and Loss Account*	

Long term capital gain on sale of equity shares on which securities transaction tax was paid	*3,60,000*
Income from units of UTI	*75,000*

The company provides the following additional information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation allowable as per Income-tax Rules is ₹ 2,80,000.

(iii) Brought forward Business Loss/Unabsorbed Depreciation:

F.Y.	***Amount as per books***		***Amount as per Income-tax***	
	Loss	***Depreciation***	***Loss***	***Depreciation***
2013-2014	*2,50,000*	*3,00,000*	*2,00,000*	*2,50,000*
2014-2015	*Nil*	*2,70,000*	*1,00,000*	*1,80,000*
2015-2016	*3,50,000*	*3,15,000*	*1,20,000*	*2,10,000*

Note: *The company paid tax under section 115JB for the A.Y.2016-17 and the loss as per books of account of the A.Y.2013-14 of ₹ 2,50,000 was deducted while computing book profit U/s 115JB.*

You are required to:

(i) compute the total income of the company for the assessment year 2017-18 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2017-18

Particulars	**₹**	**₹**
Net profit as per Profit & Loss Account		14,25,000
Add: **Items disallowed /considered separately**		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	70,000	
Provision for sales tax [is fully allowable since the sales tax has been paid before the due date]	-	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]	15,000	

Interest on deposit credited on 31.3.2017 and tax deducted in April 2017 which was deposited on 31.7.2017 [not allowed under section 40(a)(ia) @ 30%].	30,000	
Depreciation debited to profit and loss account [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	5,80,000
		20,05,000
***Less:* Items credited but not includible under business income or are exempt under the provisions of the Act**		
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from UTI, since it is not a business income.	75,000	4,35,000
		15,70,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		2,80,000
		12,90,000
Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**2,30,000**
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid	3,60,000	
Less: Exempt under section 10(38)	3,60,000	Nil
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	75,000	Nil
Total Income		**2,30,000**
Tax payable @ 30%		69,000
Add: Education cess @ 2%	1,360	
Secondary and higher education cess @ 1%	690	2,070
Tax Payable as per the Income-tax Act, 1961		**71,070**

Computation of Book Profit under section 115JB

Particulars	₹	₹
Net Profit as per Profit & Loss Account		14,25,000

***Add:* Net Profit to be increased by the following amounts as per *Explanation 1* to section 115JB**		
Provision for loss of subsidiary	70,000	
Provision for income-tax	1,05,000	
Depreciation debited to profit and loss account	3,60,000	5,35,000
		19,60,000
***Less:* Net Profit to be reduced by the following amounts as per *Explanation 1* to section 115JB**		
Depreciation debited to profit and loss account (excluding depreciation on account of revaluation of fixed assets) (i.e., ₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
Income from UTI [since it is an income exempt u/s 10(35)]	75,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,85,000
Book Profit		**10,75,000**
18.50% of book profit		1,98,875
Add: Education cess @ 2%	3,978	
Secondary and higher education cess @ 1%	1,989	5,967
		2,04,842

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit of ₹ 10,75,000 is deemed to be the total income and income-tax is payable @ 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to be ₹ 2,04,842.

The deduction of business loss as per books of account in the A.Y.2016-17 while computing book profit under section 115-JB will be of no consequence while computing the book profit under section 115JB of A.Y.2017-18.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years.

The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act.

This tax credit is allowed to be carried forward for ten assessment years succeeding the assessment year in which the credit became allowable.

Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	₹
Tax on book profit under section 115JB	2,04,842
Less: Tax on total income computed as per the other provisions of the Act	71,070
Tax credit to be carried forward under section 115JAA	**1,33,772**

Note: *Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, long-term capital gains exempt under section 10(38) is not eligible for reduction while computing book profit under section 115JB. Consequently, expenditure to earn such income should not be added back to arrive at the book profit.*

Question 40

The net profit of India Biotech Ltd which is engaged in the business of bio-technology for the year ended on 31.3.2017 works out to ₹ 45 lacs after debit/credit of the following items:

(i) Profit of ₹ 2,50,000 from a hedging contract entered into for meeting out the loss in foreign currency payments towards an imported machinery of ₹ 80 lacs installed on 1.2.2017.

(ii) Incidental charges of ₹ 20 lacs paid to a financial institution for taking short-term loan of ₹ 25 crores repayable in 18 months.

(iii) Commission of ₹ 25,000 paid to a recovery agent for getting realisation of an old outstanding debt. Tax deducted and remitted as per Chapter XVII-B of the Act.

(iv) Registration fees of ₹ 20,000 and listing fees of ₹ 30,000 paid to the Registrar of Companies and the Stock Exchange respectively for issue of bonus shares.

(v) Amount of ₹ 1,00,000 towards carry forward of losses for Asst. year 2004-05 of X Ltd., which got merged with the company during the financial year 2009-10.

(vi) Interest received from banks of ₹ 90,000 net of TDS of ₹ 10,000.

(vii) ₹ 1,50,000 incurred towards reconditioning of generator in January 2017.

(viii) Employer's share to the EPF for the month of March, 2017 of ₹ 40,000. The amount was deposited with the PF Commissioner on 22.4.2017.

Compute the total income of the company for Asst. year 2017-18 and give brief reasons for the treatment given to each of the items. Ignore the provisions of section 115JB.

Answer

Computation of Total Income of India Biotech Ltd. for A.Y. 2017-18

Particulars	₹	₹
Income from business		
Net Profit as per profit and loss account		45,00,000
Less: Items credited but to be considered separately		
Profit from hedging contract **(Note 1)**	2,50,000	
Interest from banks **(Note 6)**	90,000	3,40,000
		41,60,000
Add: Employer's share already charged in Profit & Loss Account is allowable under section 43B since it is deposited before the due date of filing return under section 139(1) i.e., 30.09.2017.		NIL
		41,60,000
Add: Depreciation on plant and machinery on account of hedging profit (7.5% on ₹ 2,50,000) **(Note 1)**	18,750	
Additional depreciation (10% on ₹ 2,50,000)	25,000	43,750
		42,03,750
Income from other sources		
Interest received from banks (gross)		1,00,000
Total Income		**43,03,750**

Notes :

1. Hedging contract is entered into for safeguarding against any loss that may arise due to currency fluctuation. The profit from such contract entered into for meeting loss in foreign currency payments towards imported machinery has to be adjusted against the cost of plant and machinery. Consequently, the same will have an impact on depreciation and additional depreciation on imported plant and machinery. It is presumed that the conditions for claim of additional depreciation are satisfied and accordingly, the additional depreciation has been charged to profit and loss account. Since there is a reduction in the cost of plant and machinery on account of hedging profit of ₹ 2,50,000, the excess depreciation and additional depreciation debited to the profit and loss account have to be added back to the profits.

2. Incidental charges incurred for raising short term loan from financial institutions is allowable as deduction, since, as per *CBDT letter F.No.32/6/62-IT(A-1) dated 16.1.1963,–*

   (i) it is in respect of a short term loan of a duration of not more than 2 years; and

   (ii) it does not exceed 1% of ₹ 25 crores, being the amount of loan raised.

3. Commission of ₹ 25,000 paid to a recovery agent for realisation of old outstanding debt is an allowable expense under section 37 as per *DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All).*
4. The Supreme Court has, in *CIT v. General Insurance Corporation (2006) 286 ITR 232,* observed that the issue of bonus shares does not result in expansion of the capital base of the company. Therefore, the expenditure incurred by the company on account of registration fees and listing fees for the issue of bonus shares is allowable as revenue expenditure.
5. As per section 72A, the unabsorbed business loss of the amalgamating company shall be deemed to be the loss of the amalgamated company for the previous year in which the amalgamation took place. Therefore, such loss can be set-off against the income of the amalgamated company in the year of amalgamation and the balance, if any, can be carried forward and set-off against the business income of the amalgamated company in the subsequent years. ***Such loss can be carried forward by the amalgamated company for a maximum period of 8 years from the year of amalgamation. In this case, the amalgamation took place in the financial year 2009-10 and therefore, the 8 year period has not expired in the financial year 2016-17. Therefore, the set-off of losses of ₹ 1 Lac relating to X Ltd. is in order. It is assumed that the conditions specified in section 72A are satisfied.***
6. Interest received from banks is chargeable to tax under the head "Income from other sources", assuming that there is no nexus between the interest income and the business of the assessee. For this purpose, the net amount of interest has to be grossed up by adding the amount of TDS of ₹ 10,000. Since the net interest of ₹ 90,000 is credited to profit and loss account, the same has to be reduced to compute the business income.
7. Expenditure on reconditioning of the generator is in the nature of normal repairs and is eligible for deduction under section 31.

Question 41

RST Ltd. is engaged in the manufacture and sale of drugs and pharmaceuticals. Its net profit for the year ended 31-3-2017 after debit/credit of the following items to the Profit and Loss Account was ₹ 28,00,000.

(i) Income-tax paid on non-monetary perquisites provided to the employees ₹ 1,00,000.

(ii) Legal fees incurred in defending title to factory premises ₹ 2,00,000.

(iii) Expenditure on in-house scientific research and development facility approved by the prescribed authority ₹ 10,00,000 [it does not include cost of land or building].

(iv) Interest paid on arrears of sales tax ₹ 1,00,000.

(v) Cash payment of ₹ 30,000 made on 10.10.2016 to a supplier towards purchase of raw material.

(vi) Rent received from letting out vacant land ₹ 1,00,000.

(vii) Arrears of rent received ₹ 2,00,000 in respect of a house property, which was let out in the earlier years and which was not charged to tax in any earlier year. The said property was sold in March 2015.

The company paid royalty in India to a resident-company of ₹ 3,00,000 on 1.5.2015, which was disallowed for the assessment year 2016-17 since tax was not deducted thereon. The company deducted and paid tax at source on the said amount of royalty on 1.1.2017.

The company has brought forward loss from property relating to the assessment year 2015-16 amounting to ₹ 40,000.

Compute the total income of RST Ltd. for the assessment year 2017-18, ignoring MAT.

Furnish explanations for the treatment of the various items given above.

Answer

Computation of total income of RST Ltd for the assessment year 2017-18

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		28,00,000
Add: Income-tax paid on non-monetary perquisites provided to employees not allowable [Section 40(a)(v)] **[Note (i)]**		1,00,000
Disallowance of expenditure in contravention of section 40A(3) [Note (v)]		30,000
		29,30,000
Less: **Deduction / Additional deduction allowable**		
Additional sum allowable towards scientific research expenditure [Section 35(2AB)(1) @ 200%]. **[Note (iii)]**	10,00,000	
Royalty paid during the year 2015-16, without deduction of tax, disallowed in A.Y.2016-17, now allowable as tax thereon is deducted and paid **[Note (viii)]**	90,000	10,90,000
		18,40,000
Less: **Income credited in the profit and loss account to be considered under other heads of income**		
Rent received from letting out vacant land **[Note (vi)]**	1,00,000	
Arrears of rent received in respect of property let out in the earlier years	2,00,000	3,00,000
		15,40,000
Income from house property		

Arrears of rent received in respect of property let out in earlier years **[Note (vii)]**	2,00,000	
Less: 30% of ₹ 2,00,000	60,000	
	1,40,000	
Less: Brought forward loss from property relating to A.Y.2015-16 set off **[Note (ix)]**	40,000	1,00,000
Income from other sources		
Rent received from letting out vacant land **[Note (vi)]**		1,00,000
Total Income		**17,40,000**

Explanations for the treatment of the various items are furnished herein below -

(i) Income-tax paid by an employer on non-monetary perquisites provided to the employees is not deductible as per section 40(a)(v).

(ii) 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). This was held by the Supreme Court in *Dalmia Jain & Co. Ltd. v. CIT (1971) 81 ITR 754.*

(iii) Expenditure on scientific research incurred by the company is entitled to deduction at the rate of 200% as per section 35(2AB). Since the company has debited ₹ 10,00,000 in the profit and loss account, the additional deduction of ₹ 10,00,000 is claimed while computing its total income[8].

(iv) 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) as held by the Supreme Court in *Lachmandas Mathurdas v. CIT (2002) 254 ITR 799.*

(v) Disallowance under section 40A(3) is attracted where cash payment in excess of ₹ 20,000 is made in respect of any expenditure. In such a case, 100% of the expenditure is disallowed. Since the cash payment made by the company is ₹ 30,000, the expenditure attracts disallowance under section 40A(3).

(vi) Rent received from letting out vacant land is assessable under the head "Income from other sources".

(vii) Arrears of rent received in respect of the house property let out in earlier years is deemed to be income from house property in the year of receipt. Such arrears of rent, after deduction of 30% thereof, is assessable as income from house property even though the

[8] W.e.f. A.Y.2018-19 it is deductible @ 150% and from A.Y.2021-22 onwards it is deductible @100% i.e. no weighted deduction would be allowed.

assessee is not the owner of the property in the year of its receipt as provided in section 25A.

(viii) Royalty paid during the previous year 2015-16 in respect of which tax was deducted and paid during the previous year ending 31.3.2017 is allowable as deduction for the assessment year 2017-18 as per the proviso to section 40(a)(ia). In the assessment year 2016-17, as per section 40(a)(ia) 30% of the expenditure would have been disallowed for non-deduction of tax at source. Since tax is deducted and paid during the financial year 2016-17, the said 30% disallowed earlier is eligible for deduction now.

(ix) Brought forward loss from house property relating to the assessment year 2015-16 is set off against the deemed income from house property for earlier years in accordance with the provisions of section 71B.

Question 42

ABC Ltd an Indian company is engaged in the manufacture and sale of textiles. Its net profit for the year ended 31.3.2017 after debit/credit of the following items to the Profit and Loss Account was ₹ 75,00,000:

(i) Payment to two employees of ₹ 2,50,000 each in connection with their voluntary retirement.

(ii) Income-tax paid ₹ 1,00,000.

(iii) Charges of ₹ 2,00,000 paid by cheque for the advertisement in souvenir published by a Political Party registered with the Election Commission of India.

(iv) Retrenchment compensation paid to employees of one of the units closed down during the year ₹ 10,00,000.

(v) Capital expenditure incurred for the purpose of promoting family planning amongst its employees ₹ 3,00,000.

(vi) Interest paid under section 234B for short payment of advance tax pertaining to the assessment year 2016-17 ₹ 1,10,000.

(vii) Loss incurred by way of trading in commodity derivative transactions in recognized stock exchange ₹ 3,00,000.

(viii) Compensation received from supplier for delay in supply of raw materials ₹ 1,00,000.

(ix) Dividend received from a foreign company ₹ 2,00,000.

Compute the total income of ABC Ltd. for the assessment year 2017-18. Ignore MAT provisions.

Furnish explanations for the treatment of the various items given above.

Answer

Computation of total income of ABC Ltd. for the Assessment Year 2017-18

Particulars	₹
Net profit as per Profit and Loss Account	75,00,000

Add: Inadmissible expenditure	
4/5th of ₹ 5,00,000 paid to employees on voluntary retirement [1/5th is allowable as deduction under section 35DDA] **[Note (i)]**	4,00,000
Income-tax paid – disallowed under section 40(a)(ii)	1,00,000
Advertisement charges of souvenir of political party under section 37(2B) **[Note (iii)]**	2,00,000
4/5th of ₹ 3,00,000, being capital expenditure incurred for promoting family planning amongst employees [1/5th is allowable as deduction under section 36(1)(ix)] **[Note (v)]**	2,40,000
Interest paid under section 234B	1,10,000
	85,50,000
Less: Dividend received from a foreign company considered under the head 'Income from other sources'	2,00,000
Business income	**83,50,000**
Income from other sources	
Dividend received from a foreign company	2,00,000
Gross total income	**85,50,000**
Less: Deduction under section 80GGB in respect of advertisement in souvenir published by a political party registered with Election Commission of India **[Note (iii)]**	2,00,000
Total income	**83,50,000**

Explanations for the treatment of the various items in computing the total income of the company are furnished below -

(i) Section 35DDA provides for amortisation of expenditure incurred under voluntary retirement scheme over a period of five years in equal instalments. The company is, therefore, entitled to deduction of ₹ 1,00,000, being one-fifth of the total sum of ₹ 5,00,000 paid to the two employees in connection with their voluntary retirement for the relevant assessment year.

(ii) Income tax paid is not allowable as deduction from business profits as per section 40(a)(ii).

(iii) Section 37(2B) prohibits allowance of any expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political party. As such, advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company.

However, under section 80GGB, expenditure incurred by an Indian company, otherwise than by way of cash, on advertisement in any publication, including a souvenir, by a political party is deemed to be a contribution of such amount to the political party and is, therefore, allowable as deduction in the hands of the company.

(iv) Retrenchment compensation paid to employees at the time of closure of one of the units of the business is allowable as per the decision of the Allahabad High Court in *CIT V. JK Cotton Spinning & Weaving Co. Ltd. (2005) 145 Taxman 591.*

(v) Capital expenditure incurred for the purpose of promoting family planning amongst employees is deductible over a period of 5 years as per the first proviso to section 36(1)(ix). Hence, only ₹ 60,000 is deductible in the current year in respect of such expenditure incurred by the company.

(vi) Interest paid for delayed payment of tax by the assessee is part and parcel of the liability to pay income-tax. When income-tax paid is itself not allowable as a deduction under section 40(a)(ii), the interest paid under section 234B cannot qualify for deduction. Thus, interest paid under section 234B is not deductible.

(vii) Loss of ₹ 3 Lacs incurred by way of trade in commodity derivatives in recognized stock exchange is not a speculative transaction in view of proviso to section 43(5). Whether the commodities underlying the transaction is related to the business of the assessee or not, such loss is not to be viewed as speculation loss.

(viii) Compensation received from supplier for delay in supplying the raw materials is a trading receipt.

(ix) Dividend received from a foreign company in assessable under the head "Income from other sources".

Question 43

Moon India Ltd. engaged in manufacturing activity furnishes the following details:

Net profit as per Profit and Loss Account ₹ 50,00,000.

(i) Depreciation charged to Profit and Loss Account is ₹ 16,00,000. Depreciation as per Income-tax Act, 1961 amounts to ₹ 28,00,000, which includes the following:

Depreciation rate meant for computers has been adopted for (i) accessories like printers and scanners; and (ii) EPABX. The written down value of these as on 1-4-2016 is given below:

(a)	*Printers and Scanners*	*₹ 50,000*
(b)	*EPABX*	*₹ 2,00,000*

Assume that there were no additions during the year.

(ii) It incurred ₹ 2,50,000 as expenditure for public issue of shares. The public issue could not materialize on account of non-clearance by SEBI. This amount is charged to Profit & Loss Account.

(iii) It incurred expenditure of ₹ 2,00,000 towards issue of debentures. This amount has been capitalized in the books.

(iv) The company paid ₹ 1,00,000 as compounding fee for violations in the pollution control regulations. This has been charged as revenue expenditure.

(v) The company lost cash of ₹ 25,00,000 due to theft when it was withdrawn from bank and taken to administrative office. It is not insured and hence, fully charged as revenue expenditure.

(vi) ₹ 5,00,000 was spent during the year towards permitted CSR activities as per 135 of the Companies Act, 2013. This is charged to Profit and Loss Account.

(vii) It paid ₹ 1,00,000 to commodity broker for commodity transactions at MCX. The amount was debited to profit and loss account and no tax was deducted at source on this payment.

(viii) It paid ₹ 50,000 to an electoral trust by cash and ₹ 1,00,000 by cheque to a registered political party. Both these are debited to Profit and Loss Account.

Compute the total income of the company for the assessment year 2017-18 Give reasons in brief for treatment of each of the above items. Ignore MAT provisions.

Answer

Computation of Total Income of Moon India Ltd. for the A.Y.2017-18

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		50,00,000
Add: Items debited but to be considered separately or to be disallowed		
Depreciation as per books of account **(Note 1)**	16,00,000	
Expenditure on public issue of shares which could not materialize due to non-clearance by SEBI **(Note 2)**	2,50,000	
Compounding fee paid for violating pollution control regulations **(Note 3)**	1,00,000	
Loss of cash in transit from bank to administrative office on account of theft **(Note 4)**	-	
Expenditure towards permitted CSR activities as per section 135 of the Companies Act, 2013 **(Note 5)**	5,00,000	
Payment to commodity broker without deducting tax at source **(Note 6)**	30,000	
Donations to electoral trust and registered political party **(Note 7)**	1,50,000	
		26,30,000
		76,30,000

Less: Items credited but to be considered separately / Expenditure to be allowed		
Depreciation allowable under the Income-tax Act, 1961 **(Note 1)**	27,10,000	
Expenditure on issue of debentures **(Note 8)**	2,00,000	
		29,10,000
Gross Total Income		**47,20,000**
Less: Deduction under Chapter VI-A		
Under section 80GGB [Donation to registered political party] **(Note 7)**	1,00,000	1,00,000
Total Income		46,20,000

Notes:

(1) Depreciation as per books of account charged to profit and loss account (i.e., ₹ 16 lakhs) has to be added back and depreciation calculated as per Income-tax Rules, 1962 (i.e. ₹ 27.10 lakhs) is allowable as deduction under section 32.

Computer accessories and peripherals like printer and scanner form an integral part of the computer system and they cannot be used without the computer; hence, they are eligible for depreciation@60% *[CIT v. BSES Yamuna Powers Ltd. (2013) 358 ITR 47 (Del.)].*

However, EPABX is not a computer and is, hence, not entitled to higher depreciation@60% *[Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)].*

Therefore, depreciation as per Income-tax Act, 1961 would be ₹ 27.10 lakhs, which is computed as follows –

Particulars	**₹**
Depreciation computed as per Income-tax Act, 1961	28,00,000
Less: Depreciation@60% wrongly provided in respect of EPABX = 60% of ₹ 2,00,000	1,20,000
	26,80,000
Add: Depreciation@15% on EPABX = 15% of ₹ 2,00,000	30,000
Correct Depreciation as per Income-tax Act, 1961	**27,10,000**

(2) 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.)].*

Since the expenditure has been charged to profit and loss account, the same has to be added back.

(3) 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 [*Millenia Developers P Ltd. v. Deputy CIT (2010) 322 ITR 401 (Kar.)]*.

Since the compounding fee has been charged to profit and loss account, the same has to be added back.

(4) 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.)]*.

In this case the loss due to theft took place when cash was withdrawn from bank and taken to administrative office. Hence, it is incidental to business and thus, allowable as revenue expenditure. Since the same has already been charged as revenue expenditure, no further adjustment is required.

(5) Any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37. Since the expenditure has been charged to profit and loss account, the same has to be added back for computing business income.

It is assumed that the CSR expenditure is not of the nature described in sections 30 to 36 of the Income-tax Act, 1961, and hence, does not qualify for deductions under those sections.

(6) The payment to commodity broker is in the nature of commission on which tax is deductible under section 194H.

Hence, payment of ₹ 1 lakh to a commodity broker for commodity transactions at MCX would attract disallowance@30% under section 40(a)(ia), due to non-deduction of tax at source under section 194H.

(7) Donation to an electoral trust and a registered political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income.

However, donation made by a company to an electoral trust or registered political party is allowable deduction under section 80GGB from gross total income, subject to the condition that payment is made otherwise than by way of cash. Since the donation to electoral trust is made in cash, the same does not qualify for deduction under section 80GGB. However, donation of ₹ 1 lakh by cheque to a registered political party would be eligible for deduction under section 80GGB.

(8) 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 *[India Cements Ltd. v. CIT (1966) 60 ITR 52 (SC)].*

Since the said expenditure has been capitalized in the books of account, the same has to be deducted to compute business income.

Question 44

XYZ Ltd. is engaged in the business of manufacturing plastic bottles. Its Profit & Loss account shows a net profit of ₹ 60 lakhs for the year ended 31st March 2017, after debiting/crediting the following items:

(i) ₹ 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.

(ii) ₹ 10,000 & ₹ 15,000 paid in cash on 15.10.2016 by two separate vouchers to a contractor who carried out certain repair work in the office premises.

(iii) One time license fee of ₹ 10 lakh paid to a foreign company for obtaining franchise on 1st July 2016.

(iv) Dividend of ₹ 3,50,000 received from a foreign company, in which XYZ Ltd. holds 28% in nominal value of equity share capital of the company. ₹ 25,000 spent on earning this income.

(v) Depreciation on tangible fixed assets ₹ 1,50,000.

(vi) ₹ 5,00,000 and ₹ 1,50,000, being amounts waived by a bank out of principal and arrear interest, respectively, in one-time settlement. The loan was obtained for meeting working capital requirements two years back.

(vii) Provision for gratuity based on actuarial valuation ₹ 5,00,000. Actual gratuity paid ₹ 1,50,000 was debited to provision for gratuity account.

(viii) The opening & closing stock of the year were ₹ 18,00,000 & ₹ 18,72,000, respectively, and were undervalued by 10% on cost.

Additional Information:

(a) Provision for audit fee of ₹ 1,00,000 was made in the books for the year ending 31/3/2016, without deducting tax at source. Such fee was paid to the auditors in September, 2016, after deducting tax u/s 194J and the tax so deducted was deposited on 7th October 2016.

(b) During the year, the company purchased 5000 shares of RK Private Ltd. at ₹ 20 per share. The fair market value of such shares on the date of transaction was ₹ 40 per share.

(c) Depreciation on tangible fixed assets as per Income-tax Rules : ₹ 1.75 lakhs.

(d) *A debt of ₹ 4 lakhs was claimed as bad debt in the previous year 2014-15. A sum of ₹ 2 lakh was recovered during the P.Y.2016-17. The effect of recovery of bad debt was not given in books of account.*

Compute the total income and tax payable by XYZ Ltd., giving the reasons for treatment of each item, for assessment year 2017-18. Ignore MAT provisions.

Answer

Computation of total income of XYZ Ltd. for the A.Y.2017-18

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		60,00,000
Add: **Items debited to profit & loss account but not allowable as deduction**		
Cash payments exceeding ₹ 20,000 in aggregate in a day to a contractor for repair work (₹ 15,000 + ₹ 10,000) **(Note 2)**	25,000	
Licence fee for obtaining franchise ₹ 10,00,000 less depreciation thereon of ₹ 2,50,000 **(Note 3)**	7,50,000	
Bad debt written off earlier, recovered now **(Note 10)**	2,00,000	
Provision for gratuity (₹ 5,00,000 - ₹ 1,50,000) **(Note 7)**	3,50,000	13,25,000
		73,25,000
Add: Difference on account of stock valuation **(Note 8)**		8,000
		73,33,000
Less: **Items credited to profit and loss account but not taxable or taxable under a different head of income**		
Dividend received from foreign company less expenditure incurred to earn dividend (₹ 3,50,000 - ₹ 25,000)**(Note 4)**	3,25,000	
Waiver of interest on bank loan **(Note 6)**	1,50,000	4,75,000
		68,58,000
Less: **Items not debited to profit and loss account but allowable as deduction**		
Provision for audit fees **(Note 9)**	30,000	
		30,000
		68,28,000
Less: Depreciation on assets (₹ 1,50,000 - ₹ 1,75,000) **(Note 5)**		25,000
		68,03,000
Income from Other Sources		
Dividend from specified foreign company **(Note 11)**	3,50,000	

Shares of closely-held company purchased for inadequate consideration **(Note 12)**	1,00,000	4,50,000
Gross Total Income		72,53,000
Deduction under Chapter VI-A		Nil
Total Income		**72,53,000**

Computation of tax liability of XYZ Ltd. for A.Y. 2017-18

Particulars	₹
Tax @15% on dividend of ₹ 3,50,000 from specified foreign company	52,500
Tax @30% on the balance total income of ₹ 69,03,000	20,70,900
	21,23,400
Add: Education cess @2% and Secondary and higher education cess @1%	63,702
Total tax liability	**21,87,102**

Notes:

(1) 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. Hence, disallowance is not attracted *[Hero Honda Motors Ltd. v. CIT (2005) 3 SOT 572 (Delhi)]*

(2) Disallowance under section 40A(3) would be attracted in respect of cash payments of ₹ 10,000 and ₹ 15,000 to a contractor, since the aggregate cash payments to him in a day exceeds the limit of ₹ 20,000.

(3) Franchise is in the nature of an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 10 lakh paid to a foreign company for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset, since it has been used for more than 180 days during the year.

(4) Dividend of ₹ 3,50,000 received from foreign company is to be taxed under the head "Income from other sources". Since the same has been credited to profit and loss account, it has to be deducted while computing business income. Consequently, expenditure of ₹ 25,000 relating to the same which has been debited to profit and loss account has to be added back. In effect, the net amount of ₹ 3,25,000 has to be deducted.

(5) Depreciation of ₹1,50,000 on tangible fixed assets debited in the books of accounts has to be added back. Depreciation of ₹ 1,75,000 computed as per Income-tax Rules, 1962 is allowable. Therefore, the net amount of ₹ 25,000 has to be deducted while computing business income.

(6) Waiver of principal amount of loan taken for trading activity is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1) *[Solid Containers vs. DCIT (2009) 308 ITR 417 (Bom)].*

Since the loan is for meeting working capital requirement, it is logical to assume that is taken for trading activity. Since the loan waiver has already been credited to profit and loss account, no adjustment is required.

However, as per section 43B, since interest is allowable only on actual payment, deduction in respect of interest due on loan would not have been allowed as deduction in any previous year. Therefore, such interest cannot be brought to tax by invoking section 41(1). Since such interest has now been credited to profit and loss account, the same has to be deducted while computing business income.

(7) As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, any provision made for the purpose of payment of a sum by way of any contribution to an approved gratuity fund or for the purpose of payment of gratuity which has become payable during the previous year shall be allowed as deduction. The question does not mention that the provision of ₹ 5,00,000 is for the purpose of contribution to an approved gratuity fund. Therefore, only gratuity of ₹ 1,50,000 paid to the retired employees is allowable as deduction. Hence, the balance provision of ₹ 3,50,000 (i.e., ₹ 5,00,000 – ₹ 1,50,000) is to be added back.

(8) Difference on account of undervaluation of opening stock and closing stock by 10% of cost to be deducted and added, respectively. Therefore, the net amount of ₹ 8,000 (₹ 72,000 × 10/90) has to be added.

(9) ₹ 30,000, being 30% of ₹ 1,00,000, representing provision for audit fees for the year ended 31.3.2016 for which tax was not deducted in the F.Y.2015-16 would have been disallowed while computing deduction for F.Y.2015-16. Since the tax is deducted and paid in F.Y.2016-17, ₹ 30,000 would be allowable as deduction in the A.Y.2017-18, as per the proviso to section 40(a)(ia).

(10) The amount of bad debt previously written off and allowed deduction is liable to tax when it is recovered – under section 41(4).

(11) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15% as against the tax rate of 30% applicable to other income of a domestic company. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of ₹ 3,50,000 received by XYZ Ltd. from a foreign company, in which it holds 28% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head "Income from other sources". No deduction is allowable in respect of ₹ 25,000 expended on earning this income.

(12) Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(viia) only if the purchasing company is also a closely-held company. It is assumed that XYZ Ltd. is a closely-held company.

Since the difference exceeds ₹ 50,000, the entire sum is taxable. Therefore, ₹ 1,00,000 [5,000 × (₹ 40 – ₹ 20)] is taxable.

Question 45

Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2017-18 it paid tax @18.50% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax U/s. 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2016-17. The company seeks your opinion on the proposed levy of interest. Advice.

Answer

The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in *Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470*, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 18.5% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 18.5%.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2017-18, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2016-17, the levy of interest under section 234B and 234C is valid.

Question 46

A domestic company is liable to pay minimum alternate tax under section 115JB for the Assessment Year 2017-18. While computing book profit under section 115JB the company claims provision for deferred tax charged to Profit & Loss account in accordance with Accounting

Standard-22 of the Institute of Chartered Accountants of India, which is sought to be disallowed by the Assessing Officer. Is the action of the Assessing Officer valid in law?

Answer

Clause (h) to the *Explanation 1* to section 115JB provides that the amount of deferred tax and any provision therefor, is to be added to the net profit of the company. Similarly, any amount credited to profit and loss account being the amount of deferred tax is to be reduced / deducted for computing the book profit under section 115JB. Therefore, the action of the Assessing Officer is valid in law.

Question 47

"NEPTUNE" is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2016 from Singapore to Chennai and vice versa and collected charges thereof amounting to ₹ 200 lacs. It left Chennai port on 15.6.2016 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.2017. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer.

Answer

M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 48

The directors of a private company are personally liable to pay the income tax due from the company but their liability does not extend towards interest and penalty payable by the company. Discuss.

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Explanation to section 179 clarifies that the expression **"tax due" includes penalty, interest or any other sum payable under the Act.** Therefore, the directors liability is not confined to tax alone but extends to penalty, interest or any other sum payable by the company.

Question 49

In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position?

Answer

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an 'assessee' in default. For the purpose of section 220(4), the person held liable under section 179 would be deemed to be an assessee in default. This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.

Under section 179, every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company.

Question 50

Tarun Shipping Co. Ltd., having its registered office in Mumbai, plies two ocean-going vessels which it owns. The registered tonnage of the two vessels are 47,516 tonnes and 200 kgs and 25,759 tonnes and 400 kgs respectively. In the accounting year 2016-17, the first vessel was operated for 360 days and the second for 200 days.

The accounts of the company reveal the following results:

(i)	*Profit from core shipping activity*	*₹ 90.50 Lacs*
(ii)	*Profit from incidental activity*	*₹ 15,000*

Compute the tax payable by the company for the assessment year 2017-18, taking note of the provisions of the law relating to taxation of income of shipping companies. Also indicate the specified conditions for the applicability of the procedure.

Answer

Computation of tax payable by Tarun Shipping Company Ltd. for the A.Y.2017-18

Particulars	₹
Tonnage income (See Working Note below)	89,86,600
Tax @ 30%	26,95,980
Add: Surcharge (Not applicable as the income is below ₹ 100 Lacs)	Nil
	26,95,980
Add: Education cess and SHEC @ 3%	80,879
Total tax payable	**27,76,859**

Working Note

Since the income under tonnage tax scheme is lower than the normal income of ₹ 90.50 Lacs, the tonnage tax scheme is taken for computing tax payable.

Computation of Tonnage Income [Section 115VG]

Particulars	Ship I ₹	Ship 2 ₹
First 1,000 tons (1000 x 70/100)	700	700
Next 9,000 tons (9,000 x 53/100)	4,770	4,770
Next 15,000 tons (15,000 x 42/100)	6,300	6,300
Balance [(22,500/800) x 29/100]	6,525	232
	18,295	**12,002**

Tonnage income	**₹**
Ship 1 (18,295 ×360)	65,86,200
Ship 2 (12,002 × 200)	24,00,400
	89,86,600

Note: Tonnage is to be rounded off to the nearest multiple of 100 tons. Hence, the first vessel will pay for 47,500 tons and the second for 25,800 tons.

As per section 115VF, the tonnage income computed under section 115VG would be deemed to be the profits chargeable under the head "Profits and gains of business or profession". This is, however, subject to fulfillment of the conditions mentioned below in the next paragraph. Then, the relevant shipping income referred to in section 115-VI(1), which includes the profit from core shipping activity (i.e. ₹ 90.50 Lacs) and the profit from incidental activity (₹ 15,000), shall not be chargeable to tax.

The following are the conditions to be fulfilled by the company for applicability of the tonnage tax scheme -

(i) An option to get assessed under Chapter XII-G has to be filed by the company.

(ii) The company is required to credit to a reserve account called Tonnage Tax Reserve Account, at least 20% of the book profits derived from its core and incidental activities to be utilized before the expiry of a period of 8 years for acquisition of a new ship for the purposes of the business of the company. Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships. However, the amount should not be used for distribution of dividends or profits or for remittance outside India as profit or for creation of assets outside India.

Question 51

A Ltd., engaged in the business of manufacturing, shows a net profit of ₹ 65.00 lacs for the financial year ended 31-3-2017. A scrutiny of the profit and loss account revealed the following:

(i) Rent of ₹ 2.40 Lacs from a commercial property owned by the company and let to a bank was included in the profit.

(ii) Loss of ₹ 5 Lacs due to non-realisation of advances given to a wholly owned subsidiary Company engaged in the business of hire-purchase financing charged to Profit & Loss Account.

(iii) Municipal taxes on commercial property debited ₹ 0.22 lacs, which were ultimately paid on 1-12-2017.

(iv) The Company has received equity shares of AB Ltd. valued at ₹ 1.25 lacs in exchange of equity shares of CD Ltd. in a scheme of amalgamation during the year. The shares in CD Ltd. were acquired in 2010-11 at a cost of ₹ 0.40 lacs. The surplus has been credited to Profit & Loss account. Both AB Ltd. and CD Ltd. are Indian companies.

(v) An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to ₹ 6.00 lacs.

(vi) As restructuring of its debt, the company has converted arrears of interest of ₹ 5.00 Lacs on term loan into a new term loan with a revised repayment schedule and charged the same to profit and loss account. The company has actually paid ₹ 0.50 lac towards such funded interest during the year.

(vii) Legal charges in connection with alteration of the Articles of Association ₹ 1.50 lacs and for issue of bonus shares ₹ 5.00 lacs.

(viii) The company has purchased scrap materials amounting to ₹ 0.60 lacs, the payment for which was made in cash on 15th August, 2016.

Compute the net income of the company for the assessment year 2017-18 (ignoring MAT) clearly indicating the basis of treatment of each item.

Answer

Computation of net income of A Ltd. for the A.Y. 2017-18

	Particulars	₹(in lacs)
I.	Income from House Property **(Working Note 1)**	1.68
II.	Profits and gains of business or profession **(Working Note 2)**	71.47
	Gross Total Income	**73.15**
	Less: Deduction under Chapter VI-A	-
	Total Income	**73.15**

Working Note 1: Computation of income from house property

Particulars	₹ (in lacs)
Gross annual value **(See Note 2 below)**	2.40
Less: Municipal taxes are not allowable as deduction since they were not paid in the previous year.	-
Net Annual Value (NAV)	**2.40**
Less: 30% of NAV	0.72
Income from house property	**1.68**

Working Note 2: Computation of income under the head "Profits and gains of business or profession"

Particulars	₹(in lacs)	₹(in lacs)
Net profit as per profit and loss account		65.00
***Add*: Inadmissible expenditure**		
(i) Loss on non-realization of advance to wholly owned subsidiary company does not arise in the normal course of business, since the assessee is engaged in the business of manufacturing and not financing. Hence, loss is to be disallowed.	5.00	
(ii) Municipal tax on commercial property is not allowable as a deduction under this head of income.	0.22	
(iii) Arrears of interest converted into funded interest term loan not allowed. However, amount of funded interest term loan paid allowed as deduction. Difference amount adjusted.	4.50	
(iv) Legal charges of ₹ 1.50 lacs for amendment of Articles of Association is deductible. [Allahabad High Court in *CIT vs Modi Spinning* & *Weaving Mills Co Ltd. (1973) 89 ITR 304].*	--	
(v) Legal expenses in connection with the issue of bonus shares is a revenue expenditure and hence allowable. [*CIT v. General*		

	Insurance Corpn.(2006) 156 Taxman 96 (SC)]	--	9.72
			74.72
***Less:* Income not taxable/considered separately**			
(i)	Rent of commercial property let out on rent to a bank. This is taxable under the head "Income from House Property" and has been considered separately.	2.40	
(ii)	Surplus on exchange of shares on amalgamation of companies – **(See Note 1 below)**	0.85	3.25
Income under the head "Profits and gains from business or profession"			**71.47**

Note:-

1. Under section 47(vii), any transfer by a shareholder, in a scheme of amalgamation, of a capital asset, being shares held by him in the amalgamating company does not attract capital gains tax, if the transfer is made in consideration of the allotment of any shares in the amalgamated company (except where the shareholder itself is the amalgamated company) and the amalgamated company is an Indian company. Since the surplus is credited to profit and loss account, it is excluded by way of deduction.
2. Rent of commercial property has been taken as its gross annual value in the absence of other information.
3. Payment of gratuity ₹ 6.00 lacs 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)].* Since it has already been debited to the profit and loss account, no further adjustment is required.
4. Payment for scrap materials was made on 15th August being the "Independence Day" on which banks are closed. Such payment is covered by Rule 6DD(j) of the Income-tax Rules, 1962. Therefore, the expenditure cannot be disallowed under section 40A(3).

Question 52

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2017-18 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1)	*Net profits as per profit and loss account as per the Companies Act, 2013*		*₹ 215 Lacs*
(2)	*Profit and Loss A/c includes:*		
	(a) Credits:	*Dividend income from Indian companies*	*₹ 20 Lacs*
		Excess realized on sale of land held as investment	*₹ 30 Lacs*
	(b) Debits:	*Depreciation on straight line method basis*	*₹ 100 Lacs*
		Provision for loss of subsidiary company	*₹ 60 Lacs*
(3)	*Depreciation allowable as per the Income-tax Rules, 1962*		*₹ 150 Lacs*

(4) *Capital gains on sale of land mentioned above as computed under Income-tax Act, 1961* *₹ 40 Lacs*

(5) *Losses brought forward as per books of account and as per Income-tax Act, 1961:*

Business loss *₹ 50 Lacs*

Unabsorbed depreciation *₹ 60 Lacs*

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue.

Answer

In the case of a company, it has been provided that where tax on 18.50% of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total income as per the Income-tax Act, 1961

Particulars	**₹ (in Lacs)**	
Net profit as per profit and loss account		215
Add: Depreciation debited to profit and loss account	100	
Provision for losses of subsidiary company	60	160
		375
Less: Dividend income – exempt under section 10(34)	20	
Excess realized on sale of land (considered separately)	30	
Depreciation allowable as per Income-tax Rules, 1962	150	200
Business Income		175
Less: Set-off of brought forward business loss		50
		125
Capital gains		40
		165
Less: Set-off of unabsorbed depreciation		60
Total Income as per Income-tax Act, 1961		**105**

II. Computation of book profit under section 115JB

Particulars	**(₹ in Lacs)**	
Net profit as per profit and loss account		215
Add: Provision for loss of subsidiary		60
Depreciation		100
		375

Less: Dividend income exempt under section 10(34)	20	
Depreciation	100	
Business loss which is less than unabsorbed depreciation	50	170
" Book Profit"		**205**

I. Computation of Tax liability under the normal provisions of the Income-tax Act, 1961

Total income as per the Income-tax Act, 1961 is ₹ 105 Lacs,

Particulars	₹
Tax payable ₹ 105 Lacs x 30%	31,50,000
Add: Surcharge @ 7%	2,20,500
	33,70,500
Add: Education cess & SHEC@ 3%	1,01,115
Total Tax payable	**34,71,615**

II. Computation of Minimum Alternate Tax

Particulars	₹
Tax @18.50% of book profit of ₹ 205 lacs	37,92,500
Add: Surcharge @ 7%	2,65,475
	40,57,975
Add: Education cess & SHEC@ 3%	1,21,739
Minimum Alternate Tax payable	**41,79,714**
Round off	**41,79,710**

Since 18.50% of book profit exceeds the tax payable as per the Income-tax Act, 1961 the book profit of ₹ 205 lacs would be deemed to be the total income and the tax payable on such total income shall be 18.5% thereof i.e. 37,92,500 plus surcharge @ 7% being ₹ 2,65,475 plus education cess and SHEC @ 3% (of tax and surcharge) being ₹ 1,21,739. Total tax liability would be ₹ 41,79,710.

Note: With regard to the company's representation, in respect of long term capital gain whether liable for book profit tax under section 115JB, it may be noted that since the excess realized on sale of land has been included in net profit computed under Schedule III of the Companies Act, 2013, it will form part of book profit [Bombay High Court judgment in *CIT v. Veekay Lal Investment Co. Pvt. Ltd. (2001) 249 ITR 597].*

Question 53

The accounts of a public company is prepared in accordance with the provisions of the Companies Act, 2013. Its Profit and Loss Account laid before the Annual General Meeting for the previous year ended 31st March, 2017 shows a net profit of ₹ 15 Lacs. The following information relevant for the purpose of computing its assessable income has been extracted from a scrutiny of the profit and loss account:

Credits In Profit and Loss A/c		**₹**
(1)	*Profit from a new industrial undertaking qualifying for deduction under section 80-IA (Net)*	*17,00,000*
(2)	*Long-term capital gains*	*3,00,000*
Debits in Profit and Loss A/c		
(1)	*Depreciation relating to 2012-13 brought forward*	*11,00,000*
(2)	*Business loss relating to 2012-13 brought forward*	*12,00,000*
(3)	*Current year depreciation*	*10,00,000*
(4)	*Penalty for infraction of law*	*1,00,000*
(5)	*Provision for sales-tax*	*3,00,000*
(6)	*Provision for doubtful debts*	*2,00,000*

Depreciation admissible under the Income-tax Rules, 1962 for the previous year is ₹ 19,50,000. The capital gain has been invested in specified assets under section 54EC. Sales tax provided in the accounts has been remitted before the due date for filing return of income. There is no loss or unabsorbed depreciation to be carried forward and adjusted as per income-tax assessment.

You are required to compute the total tax liability of the company for the assessment year 2017-18.

Answer

The impact of the provisions of section 115JB has to be ascertained and for this purpose the income-tax on the total income as computed under the Income-tax Act, 1961 has to be compared with 18.50% of the book profits ascertained under section 115JB.

Computation of total income under the Income-tax Act, 1961

Particulars	₹	₹
Net Profit as per profit and loss account		15,00,000
Add : Expenses not allowable:		
Unabsorbed Depreciation	11,00,000	
Business Loss brought forward	12,00,000	
Depreciation	10,00,000	
Penalty – not an admissible deduction	1,00,000	

Provision for doubtful debts	2,00,000	
		36,00,000
		51,00,000
Less : Expenses deductible :		
Depreciation as per Income-tax Rules, 1962		19,50,000
		31,50,000
Less : LTCG to be considered under the respective head		3,00,000
Profit and Gains from business		**28,50,000**
Capital Gains	3,00,000	
Less : Exemption under section 54EC **(See Note 4)**	3,00,000	Nil
		28,50,000
Less : Deduction under section 80-IA		17,00,000
Total Income		**11,50,000**
Tax payable @ 30.9% = ₹ 3,55,350		

Computation of Book Profit under section 115JB

Particulars	₹	₹
Net Profit **(See Note 5)**		38,00,000
Add: Provision for doubtful debts i.e. provision for diminution in value of asset i.e. debtors		2,00,000
Depreciation		10,00,000
		50,00,000
Less: Unabsorbed depreciation, since, it is lower than brought forward business loss **(See Note 3)**	11,00,000	
Depreciation	10,00,000	21,00,000
Book profit under section 115JB		29,00,000
Tax at 18.50% of ₹ 29,00,000 = ₹ 5,36,500 plus education cess & SHEC @ 3%. The tax liability is ₹ 5,52,595.		

Since tax payable on income computed as per the provisions of the Income-tax Act, 1961 is less than 18.50% of the book profit, the book profit of ₹ 29 Lacs would be deemed to be the total income and tax is payable @18.50% thereon plus 2% education cess and 1% secondary and higher education. The total tax liability would be ₹ 5,52,595.

Notes:

(1) Income from new industrial undertaking qualifying for deduction under section 80-IA will not be reduced in computing book profit under section 115JB.(2). For computing the book profits, since provision for sales-tax is an ascertained liability, it is not to be added.

(2) Book profit includes capital gains [CIT v. Veekely Investment Co Ltd. (2001) 249 ITR 597]

(3) In the question it is stated that there is no loss or unabsorbed depreciation to be carried forward and adjusted as per income-tax assessment. This indicates that the amounts debited to profit and loss account represent depreciation and business loss as per books of account. While computing book profit brought forward depreciation or business loss whichever is less (as per books of account) is deductible under section 115JB.

(4) Capital gains are not chargeable to tax as the assessee has invested the gain in specified assets mentioned in section 54EC.

(5) Students may note that the debit entries pertaining to unabsorbed depreciation and brought forward business loss are not in consonance with Schedule III of the Companies Act, 2013. These items are part of the balance sheet under the head "Reserves and Surplus" or "Profit and Loss Account", as the case may be. In order to rectify the treatment in the books of account, the following adjustments should be made:

	₹
Net Profit	15,00,000
Add: Debits incorrectly made:	
Unabsorbed depreciation	11,00,000
Brought forward business loss	12,00,000
Net Profit as per Schedule III	38,00,000

Question 54

X Co Ltd., a domestic company, holds 51% of the share capital of Y Co Ltd. which is another domestic company. Y Co Ltd. paid total dividend of ₹ 50 Lacs for the year ended on 31-03-2017 in the F.Y. 2016-17. Out of the dividend received from Y Co Ltd., X Co Ltd. distributed dividend of ₹ 15 Lacs in the financial year 2016-17.

Explain with reasons the amount of dividend chargeable to tax and dividend distribution tax payable by X Co Ltd. Would your answer be different if X Co Ltd. had distributed dividend of ₹ 60 Lacs?

Answer

The dividend received by X Co Ltd. from Y Co Ltd. is exempt from tax under section 10(34) if such dividend is covered by section 115-O.

X Co Ltd., while paying dividend distribution tax under section 115-O, is eligible to reduce the dividend received from its subsidiary company from the dividend paid / declared by it in the same financial year. Since, the dividend of ₹ 15 lacs paid by X Co Ltd. is less than the dividend of ₹ 25.5 lacs received from its subsidiary, i.e., Y Co Ltd., the tax liability under section 115-O would be Nil.

In case X Co. Ltd. had distributed dividend of ₹ 60 Lacs, the dividend distribution tax to be paid by X Co. Ltd. shall be computed as follows:

Particulars	₹ in lakh
Dividend distributed by X Co. Ltd.	60.00
Less: Dividend received from subsidiary Y Co. Ltd. (51% of ₹ 50 lacs)	25.50
Net distributed profits	**34.50**
Add: Increase for the purpose of grossing up of dividend (34.5 x 15 /85)	6.09
Gross dividend	**40.59**
Additional income-tax payable by X Co. Ltd. u/s 115-O [15% of ₹ 40.59 lakh]	6.09
Add: Surcharge@12%	0.73
	6.82
Add: Education cess@2% and SHEC@1%	0.20
	7.02

Note: *As per sub-section (1B) of section 115-O, for the purpose of grossing up, the rate specified in sub-section (1) has to be considered. The rate specified in sub-section (1) is 15%. Further, in the example given in the Explanatory Memorandum to the Finance (No.2) Bill, 2014, grossing up has been done at the rate of 15%.*

However, it is also possible to take a view that grossing up should be done at the rate of 17.304% (that is, 15% plus surcharge@12% plus education cess and SHEC@3%), which is the effective rate of dividend distribution tax.

Question 55

Fun India Limited has a carried forward credit of ₹ 2 lacs under section 115JAA(3A) of the Income-tax Act, 1961 from assessment year 2016-17. In the A.Y. 2017-18, the company's total income and book profit under section 115JB are ₹ 5 lacs and ₹ 7 lacs, respectively. Compute the tax payable by the company for assessment year 2017-18 and the amount to be carried forward under section 115JAA.

Answer

According to section 115JAA, the tax credit to be allowed under the section is the difference between the minimum alternate tax paid under section 115JB and the tax payable by the assessee on his total income computed as per the other provisions of the Income-tax Act, 1961.

The amount of tax credit determined as aforesaid can be carried forward for 10 assessment years. The brought forward tax credit shall be allowed to be set off in any assessment year to the extent of the difference between the tax on total income and minimum alternate tax which would have been payable under section 115JB for that assessment year.

Computation of tax payable by Fun India Limited for A.Y. 2017-18 and MAT credit to be carried forward to A.Y.2018-19

	Particulars	₹
A.	Total income	5,00,000
B.	Book profit	7,00,000
C.	Tax on A (30.9% of ₹ 5,00,000)	**1,54,500**
D.	Tax on B (19.055% of ₹ 7,00,000)	1,33,385
E.	Difference between C and D	**21,115**
F.	Tax credit brought forward from assessment year 2016-17	2,00,000
G.	MAT credit set-off (Being lower of E and F)	**21,115**
H.	Tax payable for A.Y.2017-18 (C - G)	1,33,385
I.	MAT credit to be carried forward to A.Y.2018-19 (F - G)	**1,78,885**

<u>Assessment of AOPs & BOIs</u>

Question 56

Two brothers say, A and B, inherited lands equally consequent to demise of their father. Subsequently, those lands were compulsorily acquired by the State Government. Both A and B received compensation, enhanced compensation and interest on enhanced compensation. They admitted these as income in their individual status. Now the Assessing Officer wants to assess income from compulsory acquisition of lands in the status of Association of Persons (AOP).

Is the action of Assessing Officer justified in law?

Answer

The issue under consideration is whether in a case where land inherited by two brothers is compulsorily acquired by the State Government, the resultant capital gain would be assessed in the status of "Association of Persons" (AOP) or in their individual status.

The facts of the case are similar to the facts in *CIT v. Govindbhai Mamaiya (2014) 367 ITR 498*, wherein the above issue came up before the Supreme Court.

The Supreme Court observed that as per section 4 of the Hindu Succession Act, 1956, income from the asset inherited by a son from his father has to be assessed as income of the son individually. Further, as per section 8 of the Hindu Succession Act, 1956, the property of the father devolves on his son in his individual capacity and not as family property. Thus, the income is chargeable to tax in their individual status.

"Association of Persons" means an association in which two or more persons join in a common purpose or common action. Thus, an association of persons could be formed only when two or more persons voluntarily combine together for certain purposes.

In this case, the property in question came to the possession of the assessees (two brothers) through inheritance i.e., by operation of law. It is not a case where any "association of persons" was formed by volition of the parties. Further, even the income earned in the form of interest is not because of any business venture of the assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case.

Thus, applying the rationale of the Supreme Court ruling in *Govindbhai Mamaiya's* case, the income from compulsory acquisition of land inherited by the legal heirs, A & B, is taxable in their individual hands and not in the status of AOP.

The proposed action of the Assessing Officer to assess such income in the status of AOP is, therefore, **not justified** in law.

Question 57

JK Associates is an Association of Persons (AOP) consisting of two members, J and K. Shares of the members are: 60%(J) and 40%(K). Income of the AOP for the previous year 2016-17 is ₹ 6 lacs.

Compute tax liability of the AOP and the members in the following situations:

(i) J and K have their income, other than income from AOP, amounting to ₹ 1 lac and ₹ 2.7 lacs, respectively.

(ii) J and K's income, other than income from AOP, amount to ₹ 1 lac and ₹ 1.20 lacs, respectively.

Answer

Computation of tax of AOP is governed by section 167B of the Income-tax Act, 1961. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOP, exceeds the basic exemption limit, then the AOP will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOP) exceeding the basic exemption limit, then the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOP as follows:

A member's share in the total income of AOP will be treated as follows:-

(i) If an AOP has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOP will not be included in his total income and will be exempt.

(ii) If the AOP has paid tax at regular rates applicable to an individual, the member's share in the income of AOP will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOP

(i) As K's income, other than that from the AOP, exceeds the basic exemption limit, the AOP shall pay tax at maximum marginal rate of 34.608 % (i.e. 30% plus 12% surcharge plus education cess@2% plus secondary and higher education cess@1%). Thus the tax payable by AOP = ₹ 6,00,000 x 34.608% = ₹ 2,07,648.

(ii) Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = ₹ 45,000 + ₹ 1,350 = ₹ 46,350.

Tax Liability of J and K

	Particulars	J ₹	K ₹
(i)	Share of profit from AOP	Exempt	Exempt
	Income from other sources	1,00,000	2,70,000
	Total Income	1,00,000	2,70,000
	Tax liability	NIL	2,000
	Less: Rebate under section 87A	-	2,000
	Total tax payable	NIL	NIL
(ii)	Share of profit from AOP	3,60,000	2,40,000
	Income from other sources	1,00,000	1,20,000
	(A)	4,60,000	3,60,000
	Tax liability	21,000	11,000
	Less: Rebate under section 87A	5,000	5,000
		16,000	6,000
	Add: Education cess@2% + SHEC@1%	480	180
	Total tax payable (B)	**16,480**	**6,180**
	Average rate of tax [B/A x 100]	3.583%	1.716%
	Total tax liability	16,480	6,180
	***Less*: Rebate under section 86 in respect of share of profit from AOP** (share in AOP x Average rate of tax)	**12,899**	**4,118**
	Tax liability of members	3,581	2,062

Question 58

Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended on 31.3.2017:

(a) "AOP & Co.", assessed at normal rates of tax, had credited in his account, amount of ₹ 96,000 as interest on capital, ₹ 4,96,000 as salary and ₹ 20,000 as share of profit.

(b) A house property located at Jaipur was purchased on 1.7.2009 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2016-17 on the borrowed capital was ₹ 4,10,000.

Compute the income and the tax liability thereon for the A.Y. 2017-18 and support your answer with brief reasons and the provisions of the Act.

Answer

Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOP, the income from the house property will not be assessed as income of the AOP, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash's share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash's share income from the AOP (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 in respect of this income which has been included in his total income but on which tax has already been paid by the AOP. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under:-

Particulars	**₹**	**₹**
Annual Value (½ share in house property used for own residence)	Nil	
Less: Interest on loan [½ share in ₹ 4,10,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 3 years, deduction would be available upto a maximum of ₹ 2,00,000. This limit of ₹ 2,00,000 applies for each member separately.	2,00,000	
Loss from house property		(-) 2,00,000
Share income from AOP & Co.		
- Interest on capital	96,000	
- Salary	4,96,000	
- Share of profit	20,000	6,12,000
Total Income		**4,12,000**

Particulars		₹
Tax on ₹ 4,12,000		16,200
Less: Rebate under section 87A		5,000
		11,200
Add: Education Cess & SHEC @ 3%		336
Tax Liability		11,536
Less: Rebate under section 86 = 11536 X 100 /4,12,000	2.80%	
Rebate available ₹ 6,12,000 x 2.80% = ₹ 17,136		
Restricted to		11,536
Tax payable		**Nil**

Question 59

T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2017, the Profit and Loss account of the business was as under:

			Figures are in ₹ '000s
Cost of goods sold	*4,250*	*Sales*	*4,900*
Remuneration to:		*Dividend from Indian companies*	*25*
T	*130*	*Capital gains-Long term (computed)*	*640*
Q	*170*		
Employees	*256*		
Interest to:			
T	*48.3*		
Q	*35.7*		
Other expenses	*111.7*		
Sales-tax penalty due	*39*		
Net profit	*524.3*		
	5,565		***5,565***

Additional information furnished:

(i) Other expenses included:

(a) wristwatches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;

(b) employer's contribution of ₹ 6,000 to the Provident Fund was paid on 14th January, 2017.

(c) *₹ 30,000 was paid in cash to an advertising agency for publicity.*

(ii) *Outstanding sales tax penalty was paid on 15th October, 2017. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.*

T and Q had, for this year, income from other sources of ₹ 3,60,000 and ₹ 2,32,000 respectively.

Required to:

(i) Compute the total income of the AOP for the assessment year 2017-18;

(ii) Ascertain the tax liability of the association for that year; and

(iii) Discuss the tax implication for that year in the hands of the individual members.

Answer

(i) Computation of total income of the AOP for A.Y.2017-18

Particulars	₹
Profit & gains of business **(See Working Note below)**	3,12,300
Long term capital gain	6,40,000
Income from other sources [Dividend is exempt under section 10(34)]	-
Total income	**9,52,300**

Working Note - Computation of profits and gains of business

Particulars	₹	₹
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of ₹ 30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹1,70,000)	3,00,000	
Sales tax penalty **(See Note 3 below)**	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Dividend from Indian companies	25,000	
Long term capital gain	6,40,000	6,65,000
Profits and gains of business		**3,12,300**

(ii) Computation of tax liability of the AOP for A.Y.2017-18

Particulars	₹	₹
Long-term capital gain (₹ 6,40,000 @ 20%)		1,28,000

Other income (₹ 3,12,300 @ 30%)		93,690
Tax on total income		**2,21,690**
Add: Surcharge @12%		26,602
		2,48,293
Add: Education cess @2% and SHEC @ 1%		7,449
Total tax due		**2,55,742**

Notes:

1. Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate.

   Since the AOP is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.

2. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.

3. 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.)*

(iii) Tax implication in the hands of members T & Q for the A.Y.2017-18

Members of the AOP have to pay tax on their total income taking in to account savings/ investments etc. The share income from AOP is not taxable in their personal assessment.

<u>Assessment of Other Entities</u>

Question 60

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

Answer

The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47*, observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, <u>is not liable to tax on account of the principle of mutuality</u>, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.

Question 61

The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2017-18, the assessee has received ₹ 3 lacs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the exigibility to tax the aforesaid receipts in the hands of the assessee.

Answer

Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in Sind Co-op Housing Society v. ITO (2009) 317 ITR 47.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, ₹ 3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

Question 62

Explain the incidence of taxation on mutual concerns.

Answer

The concept of “mutuality” means that the contributors and beneficiaries are identical. Since one cannot make profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. A mutual concern or association stands on the same principle. All the contributors to the common fund are entitled to participate in the surplus and all the participants to the surplus are contributors in the case of a mutual concern. The excess of income over expenditure in a year shall supplement the common fund for future utilization to the benefit of the contributors and the excess of expenditure over income shall be absorbed by the common fund.

Generally the surplus derived by a mutual concern is not chargeable to tax. Therefore, a trade, professional or similar association which functions on the principle of mutuality concept is not chargeable to tax, if there is any surplus on account of subscriptions, membership fees, entrance fees etc., exceeding the expenditure incurred.

However, the following additional points need to be taken into consideration-

(i) Where a mutual concern carries on the business of insurance, the profits therefrom are chargeable to tax. Section 44 provides that the profits for this purpose have to be computed in accordance with the method prescribed in the Rules contained in the First Schedule.

(ii) In the case of trade, professional or similar associations, the income derived from specific services performed for its members is chargeable to tax u/s 28(iii). However, if there is a loss on account of expenditure exceeding the subscription etc. from members, such shortfall shall be absorbed by the income chargeable to tax u/s 28(iii). This set off as per section 44A cannot exceed 50% of the total income of such associations as computed before allowing the set off.

(iii) In the case of a mutual concern, if income is derived both from mutual activity as well as from non-mutual activity, the exemption applies only to the income from the mutual activity. The income attributable to the non-mutual activity will be liable to tax as was held by the Gujarat High Court in *Sports Club of Gujarat Ltd. vs CIT (1988) 171 ITR 504.*

***Note** : Students may also refer to decisions such as Canara Bank Golden Jubilee Staff Welfare Fund v. Dy.CIT (2009) 308 ITR 202 (Karn); CIT v. Trivandrum Club (2006) 153 Taxman 481 (Ker); CIT v. Willingdon Sports Club (2008) 302 ITR 279 (Bom) and Madras Gymkhana Club v. Dy.CIT (2009) 183 Taxman 333 (Mad) to know the nuances of the principle of mutuality in various practical situations.*

Exercise

1. Discuss briefly the concept of HUF.

2 What are the schools of Hindu Law? Discuss.

3. What are the two types of partition of HUF? What is the effect of such partitions?

4. What are the circumstances under which the income of public charitable and religious trust will be subjected to income-tax at maximum marginal rate?

5. What is meant by an oral trust under the Income-tax Act? Is the income of such a trust chargeable to tax?

6. Chapter XII-G of the Income-tax Act, 1961 contains a special scheme for taxation of the income of shipping companies. With reference to this scheme, explain the meaning of the following terms -

(a) Operating ship;

(b) Qualifying company;

(c) Relevant shipping income.

7. *Chapter XII-G of the Income-tax Act, 1961 contains special provisions relating to taxation of the income of shipping companies. What are the provisions contained therein relating to amalgamation and demerger of shipping companies?*

8. *Kanpur club was a private club which provided entertainment to its members by offering accommodation, library, reading room etc. The club also earned income by letting out its marriage hall to non-members by making them as temporary members. It contended that the "doctrine of mutuality" would apply in such a case and hence, its income would not be taxable. Discuss the correctness or otherwise of the contention of the assessee-club.*

Answer

8. The concept of mutuality means that the contributors and the beneficiaries are identical. Since one cannot make a profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. In this case, however, the principle of mutuality does not apply since non-members are made temporary members only for the purpose of letting out the marriage hall. This issue came up before the Kerala High Court, *in CIT v. Trivandrum Club (2006) 153 Taxman 481*. The High Court observed that the marriage hall was being rented out to non-members by making them temporary members only for the purpose of letting out the marriage hall and the amounts received from the non-members formed part of the income of the assessee-club. The principle of mutuality, therefore, would not apply in such a case. Thus, the contention of the assessee-club is incorrect.

14

Tax Planning and Ethics in Taxation

Question 1

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of ₹ 40 Lacs on 31st January, 2017. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of ₹ 15 Lacs, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of ₹ 5 Lacs. Mr. Gavaskar would like to draw a monthly remuneration of ₹ 40,000 and also interest @10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

Answer

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(1) [In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1)] as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed to the firm under section 40(b). Interest to partners can be allowed up to 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v) the partners' remuneration shall be allowed to the extent of aggregate of -

(a) On the first ₹ 3,00,000 of book profits or in case of loss – ₹ 1,50,000 or at the rate of 90% of book profits, whichever is more

(b) on the balance of book profits – at the rate of 60%

(2) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(3) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

(4) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of ₹ 5 Lacs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(5) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. **However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience.** Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body *[Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)]* The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(6) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of ₹ 5 lacs shall be taxed in her hands under the head "salary".

(7) If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(8) The tax rate applicable to an individual depends on the level of his/her income, whereas for partnership firms it is flat rate at 30%. Surcharge @ 12% would be attracted only if total income exceeds ₹ 1 crore. For individuals, the rate of tax is at 10% on income exceeding ₹ 2,50,000 but not exceeding ₹ 5 lacs and @ 20% for income exceeding ₹ 5 lacs but not exceeding ₹ 10 lacs and @ 30% in respect of income exceeding ₹ 10 lacs for the assessment year 2017-18. There is no surcharge for total income upto ₹ 1 crore. Thereafter, surcharge @ 15% of tax would be attracted. Education cess @ 2% and Secondary and higher education cess@1% is attracted in both the cases.

Question 2

Explain the doctrine of form and substance in the context of tax planning.

Answer

The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions-** It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [*CIT v. Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 692(AP)*

(ii) **True legal relation is the crucial element for taxability -**It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction *[CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]*

(iii) **Substance (i.e. actual nature of expense) is relevant and not the form –**

(a) In the case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [*Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)*].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [*Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)*].

Question 3

Distinguish between Tax planning and Tax Evasion

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or down right fraud. It is illegal and denies the State its legitimate share of tax.

Question 4

Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.

(i) Mr. P deposits ₹ 1,00,000 in PPF account so as to reduce his total income from ₹ 3,40,000 to ₹ 2,40,000.

(ii) *SQL Ltd. maintains register of tax deduction at source effected by it to enable timely compliance.*

(iii) *An individual tax payer making tax saver deposit of ₹ 1,00,000 in a nationalised bank.*

(iv) *A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.*

(v) *A company installed an air-conditioner costing ₹ 75,000 at the residence of a director as per terms of his appointment but treats it as* fitted in quality control section in the factory. *This is with the objective to treat it as plant for the purpose of computing depreciation.*

(vi) *RR Ltd. issued a credit note for ₹ 80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana from ₹4,00,000 to ₹ 4,80,000 and reduce the income of RR Ltd. correspondingly.*

(vii) *A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.*

Answer

Tax Planning / Tax Management / Tax Evasion

	Answer	Reason
1.	Tax planning	Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.
2.	Tax management	Maintaining register of payments subject to TDS helps in complying with the obligations under the Income-tax Act, 1961.
3.	Tax planning	Making a tax saver deposit of ₹ 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.
4.	Tax management	Obtaining declaration from lenders/depositors in Form No. 15G/15H by a partnership firm and forwarding the same to Income-tax authorities is in the nature of compliance of statutory obligation under the Income-tax Act, 1961.
5.	Tax evasion	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation@10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation@15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.

6.	Tax evasion	Issuance of a credit note for ₹ 80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from ₹ 4 lakh to ₹ 4.80 lakh and to correspondingly reduce the company's total income is a method of reducing the tax liability of the company by recording a fictitious transaction. The company is liable to tax at a flat rate of 30% whereas Mr. Ramana is liable to pay tax @ 10% above the basic exemption limit of ₹ 2,50,000, since his total income does not exceed ₹ 5,00,000. Further, Mr. Ramana would also eligible for rebate of ₹ 5,000 under section 87A. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.
7.	Tax management	Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before due date is proper compliance of the statutory obligations.

Exercise

1. *Explain briefly the concept of tax planning.*
2. *Explain the tax effect of retrospective legislation with the aid of a case law.*
3. *Write short notes on the following in the context of tax planning -*
   - *(a) Doctrine of Precedence*
   - *(b) Doctrine of form and substance*
4. *What are the tax planning considerations governing the following decisions -*
   - *(i) Make or buy*
   - *(ii) Own or lease*
   - *(iii) Retain or replace.*
5. *Discuss briefly the concept of ethics in taxation.*

15

Double Taxation Relief

Question 1

Explain the term "Bilateral Relief" in the context of Double Taxation Avoidance Agreement.

Answer

Where a tax payer is resident in one country but has a source of income in another country, it gives rise to possible double taxation. The Governments of two countries can enter into a mutual agreement to provide relief to the tax payer against double taxation of the income by working out the basis on which the relief is to be granted. This is called bilateral relief.

Bilateral Relief may be granted by way of the following methods:

(a) **Exemption method: -** Under this method, the relief is provided to the assessee by taxing a particular income in only one of the two countries, which would otherwise have been taxed in both the countries.

(b) **Tax relief method: -** Under this method, the income of the assessee is taxable in both countries in accordance with their respective tax laws/DTAAs. However, the country of which the tax payer is a resident, allows him credit for the tax charged on the doubly taxed income in the other country.

Note **:** *In India, double taxation relief is provided for in sections 90 and 90A, either by way of granting relief in respect of income-tax paid in India and the other country or specified territory or by way of avoidance of double taxation of income in India and the other country or specified territory.*

Question 2

Explain in the context of provisions of the Act:

(i) The underlying idea behind DTAA.

(ii) Rate of tax in other country

Answer

(i) The underlying idea behind Double Taxation Avoidance Agreement entered between two countries is to promote mutual economic relations by relieving the tax payers from the burden of paying tax twice on the same income in two different countries.

(ii) Rate of tax in the other country means income tax and super tax actually paid in that country in accordance with the corresponding laws in force in that country after deduction of all relief due, but before deduction of any relief due in the said country on account of double taxation, divided by the whole amount of income as assessed in that country.

Question 3

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹ 5,10,000. In view of tax planning, she has deposited ₹ 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹ 32,000. She also contributed ₹ 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹ 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2017-18.

Answer

Computation of tax liability of Nandita for the A.Y. 2017-18

Particulars	**₹**	
Indian Income		5,10,000
Foreign Income		1,10,000
Gross Total Income		**6,20,000**
Less: Deduction under section 80C		
Deposit in PPF	1,50,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	32,000	
	1,82,000	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	1,50,000	
Under section 80D		
Contribution to Central Government Health Scheme ₹ 28,000 is also allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 30,000 **(See Note 1)**	28,000	
Medical insurance premium of ₹ 26,000 paid for father aged 84 years. Since the father is a non-resident in		

India, he will not be entitled for the higher deduction of ₹ 30,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.		25,000	2,03,000
Total Income			**4,17,000**
Tax on Total Income			
Income-tax (See Note below)		11,700	
Less: Rebate u/s 87A		5,000	
		6,700	
Add : Education cess @ 2%		134	
Add: SHEC @ 1%		67	6,901
Average rate of tax in India (i.e. ₹ 6,901/ ₹ 4,17,000 × 100)	1.65%		
Average rate of tax in foreign country (i.e. ₹ 11,000/ ₹ 1,10,000 ×100)	10%		
Rebate under section 91 on ₹ 1,10,000 @ 1.65% (lower of average Indian-tax rate or average foreign tax rate)			1,815
Tax payable in India (₹ 6,901 - ₹ 1,815)			**5,086**

Notes:

1. Section 80D allows a higher deduction of up to ₹ 30,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Nandita will be allowed deduction of ₹ 28,000 under section 80D, since she is a resident Indian of the age of 60 years.
2. The basic exemption limit for senior citizens is ₹ 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is 60 years old.
3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-
   (a) The assessee is a resident in India during the relevant previous year.
   (b) The income accrues or arises to him outside India during that previous year.
   (c) Such income is not deemed to accrue or arise in India during the previous year.
   (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction under section 91.

Question 4

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2015. The Indian branch has filed return of income for assessment year 2016-17 disclosing income of ₹ 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus education cess on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus education cess.

Is the action of the Assessing Officer in accordance with law?

Answer

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of the Article 24 (Non-discrimination of the Double Taxation Avoidance Agreement (DTAA), it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, *Explanation* 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this *Explanation*, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 5

Kalpesh Kumar, a resident individual, is a musician deriving income of ₹ 7,50,000 from concerts performed outside India. Tax of ₹ 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance *agreement with that country. His income in India amounted to ₹ 30,00,000. Compute tax liability of Kalpesh Kumar for the assessment year 2017-18 assuming he has deposited ₹ 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India, aged 65 years, ₹ 32,000.*

Answer

Computation of tax liability of Mr. Kalpesh for A.Y.2017-18

Particulars	₹	₹
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under section 80C**		
PPF Contribution	1,50,000	
Deduction under section 80D		
Medical insurance premium of father, being a resident senior citizen, restricted to	30,000	1,80,000
Total Income		**35,70,000**
Tax on total income		8,96,000
Add: Education cess @ 2%		17,920
Secondary and higher education cess @ 1%		8,960
		9,22,880
Average rate of tax in India [i.e., ₹ 9,22,880/₹ 35,70,000 x 100]	25.85%	
Average rate of tax in foreign country [i.e. ₹ 1,00,000/ ₹ 7,50,000 x 100]	13.33%	
Doubly taxed income	7,50,000	
Rebate under section 91 on ₹ 7,50,000 @13.33% (lower of average Indian tax rate and foreign tax rate]		1,00,000
Tax payable in India [₹ 9,22,880 – ₹ 1,00,000]		**8,22,880**

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 6

Explain the purposes for which the Central Government as per section 90 of the Income-tax Act, 1961, can enter into an agreement with any foreign country.

Answer

Section 90(1) empowers the Central Government to enter into an agreement with the Government of any country outside India or specified territory outside India for any of the following purposes -

(a) granting of relief in respect of

 (i) income on which income tax has been paid both in India and in the other country or specified territory; or

 (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, to promote mutual economic relations, trade and investment.

(b) the avoidance of double taxation of income under the Income-tax Act, 1961 and under the corresponding law in force in the other country or specified territory;

(c) exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; and

(d) recovery of income tax under the Income-tax Act, 1961, of India and under the corresponding law in force in the other country or specified territory, as the case may be.

This section also empowers the Central Government to make such provisions as may be necessary for implementing the agreement, by notification in the Official Gazette.

Question 7

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2017-18:

	(₹ In lacs)
Income from playing snooker matches in country L	*12.00*
Tax paid in country L	*1.80*
Income from playing snooker tournaments in India	*19.20*

Life Insurance Premium paid	*1.10*
Medical Insurance Premium paid for her father aged 62 years (paid through credit card)	*0.32*

Compute her total income and tax liability for the assessment year 2017-18. There is no Double Taxation Avoidance Agreement between India and country L.

Answer

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2017-18

Particulars			₹
Indian Income [Income from playing snooker tournaments in India]			19,20,000
Foreign Income [Income from playing snooker matches in country L]			12,00,000
Gross Total Income			**31,20,000**
Less: Deduction under Chapter VIA		₹	
Deduction under section 80C			
Life insurance premium of ₹ 1,10,000 paid during the previous year deduction, is within the overall limit of 1.5 lakh. Hence, fully allowable as deduction		1,10,000	
Deduction under section 80D			
Medical insurance premium of ₹ 32,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of ₹ 30,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.		30,000	1,40,000
Total Income			**29,80,000**
Tax on Total Income			
Income-tax		7,19,000	
Add : Education cess @ 2%		14,380	
Add: Secondary and higher education cess @ 1%		7,190	7,40,570
Average rate of tax in India (i.e. ₹ 7,40,570/₹ 29,80,000 × 100)	24.8513%		
Average rate of tax in foreign country (i.e. ₹ 1,80,000/₹ 12,00,000 ×100)	15.00%		
Rebate under section 91 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)			1,80,000
Tax payable in India (₹ 7,40,570 – ₹ 1,80,000)			**5,60,570**

Note : *Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-*

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

Question 8

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Explain the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

Answer

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia), the term "Permanent Establishment" includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Question 9

An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to explain whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

Answer

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, **a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.** Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91.

Question 10

The Income-tax Act, 1961 provides for taxation of a certain income earned by Mr. X. The Double Taxation Avoidance Agreement, which applies to Mr. X, excludes the income earned by Mr. X from the purview of tax. Is Mr. X liable to pay tax on the income earned by him? Discuss.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then **in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee.** This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) PAN of the assessee, if allotted;

(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654,* that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Question 11

Arif is a resident of both India and another foreign country in the previous year 2016-17. He owns immovable properties (including residential house) in both the countries. He earned income of ₹ 50 lacs from rubber estates in the foreign country during the financial year 2016-17. He also sold some house property situated in foreign country resulting in short-term capital gain of ₹ 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹ 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

You are required to state with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

Answer

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and

(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2017-18.

The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2017-18 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Question 12

Discuss the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

Answer

The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee[*CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].*

Question 13

Mr. Kamesh, an individual resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2016-17. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	₹
Income from profession carried on in India	*7,50,000*
Agricultural income in Country "X" (gross)	*50,000*
Dividend received from a company incorporated in Country "Y" (gross)	*1,50,000*
Royalty income from a literary book from Country "X" (gross)	*6,00,000*
Expenses incurred for earning royalty	*50,000*
Business loss in Country "Y" (Proprietary business)	*65,000*
Rent from a house situated in Country "Y" (gross)	*2,40,000*
Municipal tax in respect of the above house (not allowed as deduction in country "Y")	*10,000*

Note: *Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.*

The rates of tax in Country "X" and Country "Y" are 10% and 25%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2017-18.

Answer

Computation of total income of Mr. Kamesh for A.Y.2017-18

Particulars	₹	₹
Income from House Property [House situated in country Y]		
Gross Annual Value[1]	2,40,000	
Less: Municipal taxes (assumed as paid in that country)	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	69,000	
		1,61,000

[1] Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Less: Business loss in country Y set-off[2]	65,000	
		6,85,000
Income from Other Sources		
Agricultural income in country X	50,000	
Dividend received from a company in country Y	1,50,000	
Royalty income from a literary book from Country X (after deducting expenses of ₹ 50,000)	5,50,000	7,50,000
Gross Total Income		**15,96,000**
***Less:* Deduction under Chapter VIA**		
Under section 80QQB – Royalty income of a resident from literary work[3]		3,00,000
Total Income		**12,96,000**

Computation of tax liability of Mr. Kamesh for A.Y.2017-18

Particulars	₹
Tax on total income [30% of ₹ 2,96,000 + ₹1,25,000][4]	2,13,800
Add: Education cess@2%	4,276
Secondary and higher education cess @ 1%	2,138
	2,20,214
Less: Rebate under section 91 **(See Working Note below)**	**71,820**
Tax Payable	**1,48,394**
Tax payable (rounded off)	1,48,390

Working Note: Calculation of Rebate under section 91		₹
Average rate of tax in India [i.e., ₹ 2,20,214 / ₹ 12,96,000 x 100]	**17%**	
Average rate of tax in country X	**10%**	

[2] As per section 70(1), inter-source set-off of income is permitted.

[3] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

[4] It is assumed that Mr. Kamesh is not a senior citizen or very senior citizen

Doubly taxed income pertaining to country X	**₹**	
Agricultural Income	50,000	
Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)][5]	2,50,000	
	3,00,000	
Rebate under section 91 on ₹ 3,00,000 @10% [being the lower of average Indian tax rate (17%) and foreign tax rate (10%)]		30,000
Average rate of tax in country Y	**25%**	
Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	
Rebate under section 91 on ₹ 2,46,000 @17% (being the lower of average Indian tax rate (17%) and foreign tax rate (25%)]		41,820
Total rebate under section 91 (Country X + Country Y)		**71,820**

Note: Mr. Kamesh shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2016-17).

(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

[5] Doubly taxed income includes only that part of income which is included in the assessees total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – *CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

Exercise

1. *What is double taxation relief? Explain.*
2. *Explain the types of double taxation relief.*
3. *State the models on which tax treaties are generally based.*
4. *"Double taxation relief has now been extended to certain agreements adopted by the Government" - Discuss the correctness or otherwise of this statement.*
5. *How are IT-enabled Business Process Outsourcing units in India taxed? Are there any provisions in the Income-tax Act, 1961 governing taxation of such units?*
6. *Explain briefly the concept of permanent establishment.*
7. *Explain the meaning of the following terms in the context of provisions of double taxation relief: (a) Indian rate of tax; (b) Rate of tax of the said country.*
8. *An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists asks you to explain whether the credit of the tax paid on the income in that country will be allowed to him in India.*

16

Transfer Pricing and Other Provisions to Check Avoidance of Tax

Question 1

State the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

(1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

(2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the

Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 2

I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2016-17. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.

Answer

In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T.	500

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

Question 3

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of transactions of ₹ 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition *of ₹ 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.*

Answer

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of ₹ 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: *It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.*

Question 4

EF Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by EF Inc., incorporated in USA. EF Limited has borrowed funds from EF Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US $. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by EF Limited is at arm's length ('LIBOR' means London Inter-Bank Offer Rate).

Answer

One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price method (CUP). Under the CUP method, the price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

EF Inc., USA and EF Limited, the Indian company are associated enterprises since the former holds 74% shares in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 200 basis points i.e., 4% + 2% = 6%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by EF Limited, India from EF Inc., USA, is LIBOR plus 150 basis points i.e., 4% + 1.5% = 5.5%. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the EF Ltd. is not at arm's length. However, in this case, the taxable income of EF Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Question 5

Anush Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2017:

(i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2017. The total book value of assets of Anush Motors Ltd. on the date was ₹ 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2017-18 keeping in mind that the value of 1$ and of 1 EURO was ₹ 63 and ₹ 84, respectively, throughout the year.

Answer

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2017-18.

	Particulars	₹ (in crores)
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x 63)	12.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (84*1000*1/100)	840.00
Total Income		**1,171.50**

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

Note: *It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.*

Question 6

What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions?

Answer

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

Question 7

US Ltd., a US company has a subsidiary, IND Ltd. in India. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells computer monitors to CMI Ltd., another computer reseller. It sells 50,000 computer monitors to IND. Ltd. at ₹ 11,000 per unit. The price fixed for CMI Ltd. is ₹ 10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by CMI Ltd., US Ltd. is responsible for the warranty for 3 months. Both US Ltd. and IND Ltd. offer extended warranty at a standard rate of ₹ 1,000 per annum. On these facts, how is the assessment of IND Ltd. going to be affected?

Answer

US Ltd., the foreign company and IND Ltd., the Indian company are associated enterprises since US Ltd. is the holding company of IND Ltd. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells identical computer monitors to CMI Ltd., which is not an associated enterprise. The price charged by US Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e.

transaction between US Ltd. and IND Ltd.) and uncontrolled transaction (i.e. transaction between US Ltd. and CMI Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

For sale of monitors by CMI Ltd., US Ltd. is responsible for warranty for 3 months. The price charged by US Ltd. to CMI Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by US Ltd. to IND Ltd. would be:

Particulars	No.	₹
Sale price charged by US Ltd. to CMI Ltd.		10,000
Less: Cost of warranty included in the price charged to CMI Ltd. (₹ 1,000 x 3 /12)		250
Arm's length price		**9,750**
Actual price paid by IND Ltd. to US Ltd.		11,000
Difference per unit		**1,250**
No. of units supplied by US Ltd. to IND Ltd.	50,000	
Addition required to be made in the computation of total income of IND Ltd. (1,250 × 50,000)		6,25,00,000

No deduction under chapter VI-A would be allowable in respect of the enhanced income of ₹ 6.25 crores.

Note: *It is assumed that IND Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.*

Question 8

Discuss the concept of Arm's length price as envisaged in section 92C of the Income-tax Act, 1961. What are the methods under which the arm's length price, relating to an international transaction, is determined under section 92C?

Answer

"Arm's length price" is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. Section 92C deals with the method to be adopted for determining the arm's length price and the factors to be considered for applying a particular method.

Section 92C provides that the arm's length price in relation to, *inter alia,* an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of the transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:-

(a) comparable uncontrolled price method;

(b) resale price method;

(c) cost plus method;

(d) profit split method;

(e) transactional net margin method;

(f) such other method as may be prescribed by the Board. Accordingly, the Board vide *Notification No. 18/2012 dated 23.05.2012* has prescribed that the other method for determination of the arms' length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

Out of the above, the most appropriate method shall be selected in the manner as may be prescribed by the Rules. However, if more than one price is determined by the most appropriate method, then arm's length price shall be computed in the prescribed manner (based on "Range Concept").

Question 9

(a) When shall a transaction be considered as an international transaction?

(b) In what circumstances shall a transaction entered into with a person other than an associated enterprise be deemed as a transaction between two associated enterprises?

Answer

(a) As per section 92B, an international transaction is one which satisfies the following criteria -

(i) A transaction between two or more associated enterprises, either or both of whom are non-residents;

(ii) It is in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, lending/borrowing money or any other transaction having a bearing on the profits, income, losses or assets of such enterprises;

(iii) It includes a transaction in the nature of a mutual agreement, or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred (or to be incurred) in connection with a benefit, service or facility provided (or to be provided) to any one or more of such enterprises.

Note: *Please refer to Chapter 16 of the Study Material for understanding the scope of international transaction.*

(b) As per the provisions of section 92B(2), in respect of a transaction entered into by an enterprise with a person other than an associated enterprise (hereinafter referred to as "other person"),

- there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise **or**,
- where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; **and**
- either the enterprise or the associated enterprise or both of them are non-residents,

then such transaction entered into between the enterprise and the other person shall be deemed to be an **international transaction** entered into between two associated enterprises, ***whether or not such other person is a non-resident.***

Question 10

R, an individual resident in India, bought 1,000 equity shares of ₹ 10 each of A Ltd. at ₹ 50 per share on 30.5.2016. He sold 700 equity shares at ₹ 35 per share on 30.9.2016 and the remaining 300 shares at ₹ 25 per share on 20.12.2016. A Ltd. declared a dividend of 50%, the record date being 10.8.2016. R sold on 1.2.2017, a house from which he derived a long-term capital gain of ₹ 75,000.

Compute the amount of capital gain arising to R for the assessment year 2017-18.

Answer

The amount of capital gains arising to R has to be computed applying the provisions of sub-section (7) of section 94, which provides that "where:

(a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and

(b) such person sells or transfers -

 (i) such securities within a period of three months after such date; or

 (ii) such unit within a period of nine months after such date; and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax".

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend; "securities" includes stocks and shares.

Computation of capital gains of Mr. R for the assessment year 2017-18

Particulars	₹	₹
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 gains		**60,500**

Computation of capital gain on sale of shares of A Ltd. by Mr. R

Date of purchase of shares		30.5.2016
Record date		10.8.2016
Date of sale of shares	30.9.2016	20.12.2016
Number of shares sold	700	300
Sale price per share	₹ 35	₹ 25

Particulars	₹	₹
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7) [700×10×50%] [See Note below]	3,500	Not deductible
Short-term capital loss on sale of shares	**7,000**	**7,500**

Note:

(1) 700 shares are sold within 3 months after the record date. Hence, as per section 94(7), the related dividend income should be deducted from the loss.

(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of ₹ 1,500 should not be deducted. Such dividend is exempt under section 10(34).

(3) Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.

Question 11

What are the "specified domestic transactions" which are subject to transfer pricing provisions?

Answer

As per section 92BA, the specified domestic transactions, which are subject to transfer pricing provisions, means any of the following transactions, not being an international transaction, namely-

(1) Any expenditure in respect of which payment has been made or is to be made to a related person referred to in section 40A(2)(b);

(2) Any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or *vice versa*, for consideration not corresponding to the market value on the date of transfer;

(3) Any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;

(4) Any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);

(5) Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or

(6) Any other transaction as may be prescribed.

However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹ 20 crore.

Question 12

XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2016-17.

(i) XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.

(ii) XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.

(iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

Assume the rate of exchange as 1 $ = ₹ 64

XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2017 was ₹ 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. State whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

Answer

XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars		₹ in lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla Inc. ($ 1 x 1,00,000 x 64)	64.00
(ii)	Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 x 64)	1.92
(iii)	Difference for excess payment for services to Zilla Inc. ($ 5,000 x 64)	3.20
		69.12
XE Ltd. cannot claim deduction under section 10AA in respect of ₹ 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)		

Question 13

Discuss the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) *Transfer pricing rules shall have no implication where income is computed on the basis of book profits.*

(ii) *Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.*

Answer

(i) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the Companies Act can be increased/decreased only by the additions and deductions specified in *Explanation 1* to section 115JB.

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the profit and loss account is not drawn up in accordance with the relevant Schedule of the Companies Act

(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is <u>not</u> correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

Exercise

1. *Discuss the meaning of the term "Arm's length principle" and its significance.*
2. *Discuss the meaning of the following terms -*
   - *(a) Associated Enterprise*
   - *(b) International Transaction*
3. *What is the procedure for making reference to a Transfer Pricing Officer?*
4. *In the context of transfer pricing provisions in relation to international transactions, what are the factors to be considered while selecting the most appropriate method?*
5. *What are the information and documents prescribed under Rule 10D to be kept and maintained by the assessee?*
6. *Write short notes on -*
   - *(a) Bond washing transactions*
   - *(b) Dividend stripping.*

17

Foreign Collaboration

Question 1

"X", while making payment to a non-resident for providing technical services on a world bank aided project "Net of Tax", had deducted tax as per rates prescribed but says that the payee is not entitled for the TDS certificate since the tax was not to be borne by the payee as per agreement. Examine.

Answer

Section 195A provides that where under an agreement, the tax chargeable on any income is to be borne by the person by whom the income is payable, then, for the purpose of deduction of tax at source, such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under the agreement. The CBDT has, vide *Circular No.785 dated 24.11.99*, clarified that even in those cases where the tax has been borne by the payer of income under an agreement, the payer is under a legal obligation to furnish a TDS Certificate as per the provisions of section 203 of the Income-tax Act, 1961. Therefore, the contention of Mr. X that the payee is not entitled for TDS certificate is incorrect.

Question 2

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2017 was a loss of ₹ 100 lacs after charge of head office expenses of ₹ 200 lacs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2017-18.

Answer

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of ₹ 200 Lacs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2017-18 will be as under:

Particulars	₹
Net loss for the year ended on 31.03.2017	(100 lacs)
Add: Amount of head office expenses to be considered separately as per section 44C	200 lacs

Adjusted total income	100 lacs
Less: Head Office expenses allowable under section 44C is the lower of	
(i) ₹ 5 lacs, being 5% of ₹ 100 lacs and	
(ii) ₹ 200 lacs.	5 lacs
Income to be declared in return	**95 lacs**

Question 3

A foreign company, ST, has entered into an agreement with an Indian Company KN for supply of know-how and the agreement is within the Industrial Policy conditions laid down by the Central Government. In the year 2016-17, ₹ 50 Lacs was paid, under the agreement, to ST by KN.

ST claims to have spent ₹ 14 Lacs as expenses in India to be recognized as a deduction. In the following situations, what will be your decision on the tax liability of the parties:

(i) The agreement having been entered into before 1st June, 2002 and approved by the Government, KN pays to the Indian income-tax authorities the tax payable by ST;

(ii) There is no term in the agreement that KN has to bear the tax liability; the royalty payable is decided to be ₹ 59 Lacs (net of taxes) instead of ₹ 50 Lacs.

Answer

(i) As per section 10(6A), in the case of a foreign company deriving income by way of royalty or fees for technical services from the Government or an Indian concern under the terms of an agreement entered into before 1.6.2002 relating to a matter included in the industrial policy of the Central Government, the tax paid by the Government or an Indian concern on such income would not be included in the total income of the foreign company. Hence, such tax paid would be exempt in the hands of the foreign company.

Therefore, in the present case, the tax paid by KN will be exempt from tax in the hands of ST. In this case, section 195A is not applicable and consequently, the royalty of ₹ 50 Lacs should not be grossed up. As per section 44D, where a foreign company receives income by way of royalty from an Indian concern in pursuance of an agreement made on or after 1st April, 1976 but before 1st April, 2003, no deduction is allowable in respect of any expense or allowance under sections 28 to 44C in computing such income.

The rate of tax is 10% as per section 115A(1)(b)(A), if the royalty is received in pursuance of an agreement made after 31.3.1976.

(ii) Since there is no term in the agreement that KN has to bear the tax liability, the benefit under section 10(6A) is not available. KN has to deduct tax at source on royalty payment to ST, a foreign company, as per section 195. Since in this case, KN has to pay the royalty of ₹ 59 lacs 'net of taxes' to ST, therefore, the royalty has to be grossed up.

The tax liability of ST has to be computed as under:	₹
Net royalty income	59,00,000
Gross royalty income (₹ 59,00,000x100/89.7)	65,77,480

Tax on royalty of ₹ 65,77,480 @ 10.30%	6,77,480

KN has to deduct this tax of ₹ 6,77,480 at source under section 195.

Question 4

XY Pvt. Ltd., a company having registered head office in Singapore, for the first time had carried out operations during the year 2016-17 of purchase of goods in India on four occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was ₹ 100 Lacs, on which it earned profits of ₹ 20 Lacs, before the expenses of ₹ 12 Lacs, which were directly paid by H.O. The company seeks your advice regarding its tax liability in India:

How much of income for the A.Y. 2017-18 shall be subjected to tax? Assume that the place of effective management of XY Pvt. Ltd is in Singapore.

Answer

Section 2(26) defines an "Indian Company". The proviso to section 2(26) states that for a company to be an Indian company, the registered or principal office should be in India. In this case, since the registered office is in Singapore, XY Pvt. Ltd. is not an Indian company.

A company, other than an Indian company, would be considered as resident in India only if the place of effective management is in India in that year. In this case, the POEM is not in India and therefore, XY Pvt. Ltd. is not resident in India.

XY Pvt. Ltd. is a non-resident assessee during the previous year relevant to assessment year 2017-18. As per *Explanation 1(b)* of section 9(1)(i), no income shall be deemed to accrue or arise in India to a non-resident through or from operations which are confined to purchase of goods in India for the purpose of export. XY Pvt. Ltd. had purchased the goods in India and thereafter exported the same in total to China and accordingly no income of the non-resident company shall be subject to tax for assessment year 2017-18.

Question 5

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2016-17 (April, 2016 to March, 2017) and collected charges of ₹ 125 lacs for carriage of passengers and cargo out of which ₹ 65 lacs were received in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were ₹ 195 lacs. Compute the income chargeable to tax of the foreign airlines.

Answer

Under section 44BBA, a sum equal to 5% of the aggregate of the following amount is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession" in respect of a non-resident, engaged in the business of operation of aircraft -

(a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines is as follows

Particulars	Fare booked from India to outside India whether received in India or not (₹)	Fare booked from New York to Mumbai	
		If received in India (₹)	If not received in India (₹)
Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000	65,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	3,25,000 (65,00,000 × 5%)	Nil

Question 6

A foreign company has entered into an agreement with an Indian company on 1st February 2002 under which industrial equipment belonging to the former has been leased to the latter for an annual lumpsum payment of $ 50,000. How will the lease rent be taxed in the hands of the foreign company in respect of assessment year 2017-18?

Answer

Under clause (iva) of *Explanation 2* to section 9(1)(vi), the expression "royalty" would include any lump sum consideration for the use of or the right to use of any industrial, commercial or scientific equipment. Under section 44D, no deduction will be allowed in respect of any expenditure or allowance in computing the income by way of royalty, received from the Government or an Indian concern in pursuance of an agreement made between 01.04.1976 and 31.03.2003.

Under section 115A, income-tax payable on such royalty under an agreement entered into after 31st March, 1976 will be 10%. This will be subject to the provisions of the Double Taxation Avoidance Agreement between India and the country in which the foreign company is assessed.

Exercise

1. *Discuss the taxability of the following income in the hands of a non-resident -*

   (a) Interest income; (b) Royalty; (c) Fees for technical services.

2. *Who are representative assessees? Discuss the rights and liabilities of a representative assessee.*

3. *Discuss the different forms in which foreign collaboration may be made and the tax implications involved therein.*

18

Business Restructuring

Question 1

PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for ₹ 385 lacs to a new company called S Limited, in which it holds 74% equity shares.

The balance sheet of PQR limited as on 31st March 2017, being the date on which software unit has been transferred, is given hereunder –

Balance Sheet as on 31.3.2017

Liabilities	*₹ (in lacs)*	*Assets*	*₹ (in lacs)*
Paid up Share Capital	300	Fixed Assets	
General Reserve	150	Hardware unit	170
Share Premium	50	Software unit	200
Revaluation Reserve	120	Debtors	
Current Liabilities		Hardware unit	140
Hardware unit	40	Software unit	110
Software unit	90	Inventories	
		Hardware unit	95
		Software unit	35
	750		**750**

Following additional information are furnished by the management:

(i) The Software unit is in existence since May, 2013.

(ii) Fixed assets of software unit includes land which was purchased at ₹ 40 lacs in the year 2007 and revalued at ₹ 60 lacs as on March 31, 2017.

(iii) Fixed assets of software unit mirrored at ₹ 140 lacs (₹ 200 lacs minus land value ₹ 60 lacs) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 90 lacs.

(a) Ascertain the tax liability, which would arise from slump sale to PQR Limited.

(b) What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?

Answer

(a) As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of PQR Limited from slump sale of software unit

Particulars	₹ (in lacs)
Sale consideration for slump sale of Software Unit	385
Less: Cost of acquisition being the net worth of Software Unit	185
Long term capital gains arising on slump sale	200
(The capital gains is long-term as the Software Unit is held for more than 36 months)	
Tax liability on LTCG	
Under section 112 @ 20% on ₹ 200 lacs	40.00
Add: Surcharge@ 7%	2.80
	42.80
Add: Education cess@2% and SHEC@1%	1.28
	44.08

Working Note:

Computation of net worth of Software Unit

	₹ (in lacs)
(1) Book value of non-depreciable assets	
(i) Land (Revaluation not to be considered)	40
(ii) Debtors	110
(iii) Inventories	35
(2) Written down value of depreciable assets under section 43(6) ***(See Note below)***	90
Aggregate value of total assets	275

Less: Current liabilities of software unit	90
Net worth of software unit	185

Note : *For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).*

(b) Tax advice

(i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.

(ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

Question 2

Axel Ltd. has two industrial undertakings. Unit I is engaged in the production of television sets and Unit II is engaged in the production of refrigerators. The company has, as part of its restructuring program, decided to sell Unit II as a going concern by way of slump sale for ₹ 260 lacs to a new company called Gamma Ltd., in which it holds 85% equity shares. The following is the extract of the balance sheet of Axel Ltd. as on 31st March, 2017:

	₹ (in lacs)	
	Unit – I	***Unit – II***
Fixed Assets	*112*	*158*
Debtors	*88*	*67*
Inventories	*60*	*23*
Liabilities	*33*	*45*

	₹ (in lacs)
Paid-up share capital	*231*
General Reserve	*160*
Share Premium	*39*
Revaluation Reserve	*105*

The company set up Unit II on 1st April, 2012. The written down value of the block of assets for tax purpose as on 31st March, 2017 is ₹ 150 lacs of which ₹ 60 lacs are attributable to Unit II.

(i) Determine what would be the tax liability of Axel Ltd. on account of Slump sale;

(ii) How can the restructuring plan of Axel Ltd. be modified, without changing the amount of consideration, in order to make it more tax efficient?

Answer

(i) As per section 50B, any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of Axel Ltd. from slump sale of Unit II

Particulars	₹
Slump sale consideration	2,60,00,000
Less : Cost of acquisition (net worth) [*See Working Note below*]	1,05,00,000
Long-term capital gain (as Unit II is held for more than 36 months)	**1,55,00,000**
Calculation of tax liability	
Income tax @ 20% (Being long term capital gain under section 112)	31,00,000
Surcharge @ 7%	2,17,000
	33,17,000
Education cess @ 2% and Secondary and higher education cess @ 1%	99,510
Total tax liability	**34,16,510**

Working Note: Net worth of Unit II

Particulars	₹
WDV of block of assets	60,00,000
Debtors	67,00,000
Inventories	23,00,000
	1,50,00,000
Less : Liabilities	45,00,000
Net worth	**1,05,00,000**

(ii) Tax Advice

(a) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempted from tax under section 47(iv). Therefore, if it is possible for Axel Ltd. should try to acquire the entire shareholding of Gamma Ltd. and thereafter make a slump sale, then the resultant capital gain shall not attract tax liability. However, in such case also, Axel Ltd. should not transfer any shares in Gamma Ltd. for 8 years from the date of slump sale.

(b) Alternatively, if acquisition of 15% share is not feasible, Axel Ltd. may think about demerger plan of Unit II to get benefit of section 47(vib) of the Income-tax Act, 1961.

Question 3

Your client, Ashavari Ltd. has two industrial undertakings-one engaged in production of audio music CDs and cassettes and the other engaged in production of video CDs. As a restructuring drive, the company has decided to sell its undertaking producing video CDs as a going concern by way of slump sale for ₹ 450 Lacs to a new company called Tori Ltd., in which it holds 75% equity shares. The balance sheet of Ashavari Ltd. as on 31st March, 2017 reads as follows:

	₹ in Lacs	
	Audio Unit	***Video Unit***
Fixed Assets	*150*	*225*
Debtors	*150*	*112.5*
Inventories	*75*	*37.5*
Liabilities	*42*	*75*
Paid up share capital		*₹ 378 Lacs*
General Reserve		*₹ 222 Lacs*
Share premium		*₹ 33 Lacs*
Revaluation Reserve		*₹ 140 Lacs*

The company set up the video unit on 1st April, 2011. The written down value of the block of assets for tax purpose as on 31st March, 2017 is ₹ 200 lacs of which ₹ 85 lacs are attributable to video unit.

(i) Determine the tax liability which would arise to Ashavari Ltd. from slump sale;

(ii) Suggest modification of the restructuring plan of Ashavari Ltd. without changing the amount of consideration so as to make it more tax efficient.

Answer

(i) As per section 50B, any profits or gains arising from the slump sale in the previous year is chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer takes place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before such slump sale, the capital gain shall be deemed to be long-term capital gain.

Particulars	₹
Calculation of capital gains	
Slump sale consideration	4,50,00,000
Less: Cost of acquisition (net worth) [See Working Note below]	1,60,00,000
Long-term capital gain	**2,90,00,000**
Calculation of tax liability	
Income tax @ 20%	58,00,000
Surcharge @ 7%	4,06,000
	62,06,000
Education cess @ 3%	1,86,180
Total tax liability	**63,92,180**

Working Note:

Net worth of Video unit	₹
WDV of block of assets	85,00,000
Debtors	1,12,50,000
Inventories	37,50,000
	2,35,00,000
Less: Liabilities	75,00,000
Net worth	**1,60,00,000**

Note *- Indexation benefit is not available in the case of slump sale as per section 50B(2)*

(ii) (a) Transfer of any capital asset from a holding company to its 100% Indian subsidiary company is exempt from tax under section 47(iv). Therefore, if it is possible for Ashavari Ltd to acquire the entire shareholding of Tori Ltd and then make a slump sale, the resultant capital gain shall not attract capital gains tax.

However, Ashavari Ltd should not transfer any shares in Tori Ltd for a period of 8 years from the date of such (slump) sale.

(b) Alternatively, if acquisition of 25% share is not feasible, Ashavari Ltd. may think about demerger plan of video unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

Question 4

The Balance sheet of JB Opticals Limited as on 31-03-2017 reads as under:

Paid up capital *₹ 2,52,00,000*

	Unit A (₹)	*Unit B (₹)*
Fixed assets	*1,00,00,000*	*1,50,00,000*
Debtors	*1,00,00,000*	*75,00,000*
Liabilities	*28,00,000*	*50,00,000*
Stock in trade	*50,00,000*	*25,00,000*
Reserves		*1,48,00,000*
Share premium		*22,00,000*

The company acquired Unit B on 1.04.2014. They made certain capital additions in the form of Generator set and additional building etc., for ₹ 25 lacs during the year 2014-15. The members of the company have authorized the Board in their meeting held on 28.01.2017 to dispose of Unit 'B'. The company decides to sell Unit 'B' by way of slump sale for ₹ 225 lacs as consideration. JB Opticals Ltd. has offered 1% discount if the buyer closes the sale and makes payment before 31.03.2017. However, this discount would not be available if the sale is completed (and payment is made) after 31.03.2017. You are required to advise the company as a measure of tax planning to determine the date of sale keeping in view the capital gains tax. Assume that the written down value of the fixed assets as per section 43(6) is ₹ 120 lacs.

Answer

Determination of net worth of Unit B of M/s. J.B. Opticals Ltd.

	₹ (in lacs)
Written down value of fixed assets	120
Debtors	75
Stock-in-trade	25
	220
Less : Liabilities	50
Net worth	**170**

Comparative calculation of chargeable capital gains

	Sale before 31.3.2017	**Sale after 31.03.2017**
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	2,25,000	Nil
Net sale consideration	2,22,75,000	2,25,00,000
Less: Net worth	1,70,00,000	1,70,00,000
Short term capital gain	52,75,000	N.A.

Long term capital gain	N.A.	55,00,000
Tax rate	30.9%	20.6%
Tax thereon	16,29,975	11,33,000

***Note**: The assessee is advised to effect slump sale after 31.03.2017 as the tax liability arising out of long term capital gains is less than the tax liability arising on short term capital gains, if transferred before 31.03.2017.*

Exercise

1. *What is meant by "business restructuring"? What are the various forms of business restructuring?*
2. *What are the tax benefits available on amalgamation of one company with another? What are the conditions required to be fulfilled by the amalgamating and amalgamated company for availing such tax benefits?*
3. *Define "demerger". What are the tax benefits available to the resulting company on account of demerger?*
4. *Write short notes on -*
   (a) *Redemption of preference shares*
   (b) *Conversion of debentures into shares.*
5. *What are the tax effects on conversion of -*
   (a) *a sole proprietory business into a company; and*
   (b) *a partnership firm into a company.*
6. *What is meant by "Slump sale"? Discuss the provisions of the Income-tax Act, 1961 relating to slump sales.*
7. *Write short notes on -*
   (a) *Buyback of shares*
   (b) *Capital reduction*

19

Taxation of E-Commerce Transactions

Question 1

"The existence of a website on Indian Soil constitutes a permanent establishment". Is this statement correct? Examine.

Answer

The term "permanent establishment" has not been defined in section 2 of the Income-tax Act, 1961. As per section 92F(iiia), "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

The term "permanent establishment" includes (a) a place of management (b) a branch, (c) an office, (d) a factory, (e) a workshop, (f) mines, (g) warehouse, etc. In most of the DTAAs, an exhaustive definition of the term "permanent establishment" is given, wherein several more items are enumerated.

A website is a set of web documents belonging to a particular organization. It consists of data and programs in digital form, from which it is stored in a server which is accessible through internet.

A website does not normally imply "a fixed place of business", even though in the case of some entities, some business could be transacted through a website. Thus, the mere presence of a website in Indian soil, without anything more, will not amount to a permanent establishment.

If the website contains merely information about the concern, the website cannot be regarded as a permanent establishment. Where the website is being using as a virtual office for transacting orders of purchases or sales or for rendering services on a more than casual basis, then it could be regarded as a permanent establishment.

Question 2

Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.

Answer

The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the

Income-tax Act, 1961 are **absence of national boundaries, non-requirement of physical presence of goods and non-requirement of physical delivery in e-commerce transactions.** Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

Question 3

E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Answer

E-commerce transactions, in its widest sense, means business transactions conducted over a network, using computers and telecommunication. E-commerce is a method of transacting business and is not a transaction by itself. Such a method will involve electronic advertising, electronic sales and electronic delivery.

The issues involving e-commerce transactions are as follows:

(i) Traditional business rests squarely on the physical presence and delivery of goods, but e-commerce transcends geographical barriers.

(ii) Income out of an international transaction is subject to tax both in the Home State by virtue of "personal attachment" to the transfer and in the host State by virtue of "economic attachment" to the income itself. Thus, this gives rise to double taxation of the same income.

(iii) Tax treaties seek to tax profits on the basis of what is popularly known as "Permanent Establishment". However, in the case of e-commerce transactions, no establishment is required across the border to carry on business.

(iv) Taxable jurisdiction of any country covers its national boundaries. E-commerce takes place through satellite and the server can be in any part of the globe and in all probability, in a tax haven country.

(v) For adopting the existing principles to e-commerce situations, there are two key factors to be considered:

 (a) the extent to which a web-site can constitute a permanent establishment and how income may be attributed to it;

 (b) the manner in which payments for digitized products are to be characterized.

Question 4

ABC Ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name "PUREWOOD". In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2016-17, ABC Ltd. paid ₹ 5 lakhs to PQR Inc. for such services. Discuss the *tax implications / TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –*

(i) PQR Inc. has no permanent establishment in India

(ii) PQR Inc. has a permanent establishment in India

Answer

Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ₹ 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, ABC Ltd. is required to deduct equalisation levy of ₹ 30,000 i.e., @6% of ₹ 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on ₹ 5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

Exercise

1. Explain what is meant by "e-commerce".

2. Discuss the issues and problems in taxing e-commerce transactions.

3. Explain how businesses are transacted through e-commerce.

4. How is existence of a permanent establishment determined in e-commerce situations?

5. Explain in detail the manner of taxation of income arising from e-commerce transactions.

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Income Tax Authorities

Question 1

Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year 2016-17 on 31st July, 2016, last date for filing the same, he found it extremely difficult to do the same due to network problems and ultimately he became successful in making e-filing of his return only at 1 a.m. on 1st August, 2016. The return contained a claim for carry forward of business loss of ₹ 1 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on 1st August, 2016 during normal office hours. Rajesh made a request to the CBDT for condonation of delay in filing the return of income.

Discuss whether the CBDT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

Answer

Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of "any other relief available under the Act". Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

The facts of the case are similar to the case of *Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441*, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

Applying the rationale of the above court ruling to the case on hand, the CBDT has the power to condone the delay in filing the return of income of Mr. Rajesh and permit carry forward of business loss of ₹ 1 lakh, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

Question 2

Explain the duty of an Assessing Officer under section 220(6) as summarized by the following statement: "The Assessing Officer while acting under section 220(6) should not act as a mere tax-gatherer but as a quasi-judicial authority."

Answer

As per section 220(6), where an assessee has presented an appeal under section 246A, the Assessing Officer may, in his discretion and subject to such conditions as he may think fit to impose in the circumstances of the case, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, as long as such appeal remains undisposed of.

Being a quasi-judicial authority, the powers should be exercised judiciously, keeping in mind that –

(a) The power under section 220(6) is coupled with a duty to take into consideration all relevant grounds. It should be exercised reasonably and fairly and not arbitrarily or based on matters extraneous or irrelevant.

(b) The Assessing Officer should apply his mind to the relevant factors such as the assessment history of the assessee, his conduct and co-operation to the Department, the points raised in appeal, chances of recovery in case the appeal is dismissed, the hardship to the assessee by insistence on immediate payment, etc.

(c) He must remember that he is not the final arbiter of the dispute involved, but only the first amongst the statutory authorities. [*Rajan Nair v ITO (1987) 165 ITR 650 (Ker.)*].

Question 3

Examine the correctness of the statement "the jurisdiction of an Assessing Officer cannot be objected by the assessee".

Answer

According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:

(i) **where a return has been filed** under section 139(1) then, within one month from the date of service of notice under section 142(1) or section 143(2) or before the completion of assessment, whichever is earlier.

(ii) **where no return has been filed,** then, within the expiry of time allowed by the notice under section 142(1) or section 148 for filing the return or within the time allowed in show cause notice issued seeking as to why a best judgment assessment under section 144 should not be made, whichever is earlier.

(iii) where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A, within one month from the date on which he was served with a notice under section 153A(1) or 153C(2) or before the completion of assessment, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that "the jurisdiction of an Assessing Officer cannot be objected by the assessee" is not correct.

Question 4

The Director General of Income Tax after getting the information that Mr. Mogambo is in possession of unaccounted cash of ₹ 50 lacs, issued orders by invoking powers vested in him as per section 131(1A), for its seizure. Is the order for seizure of cash issued by the Director General of Income Tax correct? If not, does the Director General of Income Tax have any other power to seize such cash?

Answer

The powers under section 131(1A) deal with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A).

However, under section 132(1), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search [Clause (iii) of section 132(1)], if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed [Clause (c) of section 132(1)]. Therefore, the proper course open to the Director General is to exercise his power under section 132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. Mogambo and seize such unaccounted cash.

Question 5

The premises of Ganesh were subjected to a search under section 132 of the Act. The search was authorized and the warrant was signed by the Joint Commissioner of Income-tax having jurisdiction over the assessee, consequent to information in his possession. The assessee challenged the validity of search on the ground that section 132(1) does not empower Joint Commissioner to authorise a search under the Act. Decide the correctness of the contention raised by the assessee.

Answer

Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations. The authorities empowered to issue authorization include such Additional Director, Additional Commissioner, Joint Director and Joint Commissioner as are empowered by the CBDT to do so.

However, a Joint Commissioner can issue warrant of authorization only if he has been specifically empowered to do so by the CBDT. Therefore, if the Joint Commissioner has not been specifically empowered by the CBDT to do so, the contention of the assessee would hold good.

Question 6

State whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132. Discuss.

Answer

As per section 132(1)(c), authorization for search and seizure can take place if the authority, in consequence of *information in his possession*, has *reason to believe* that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorized.

The Apex Court in *UOI v Ajit Jain [2003] 260 ITR 80* has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute "information" within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the assessment made pursuant to such search was not valid.

Question 7

In the course of search operations under section 132 in the month of July, 2016, a tax payer makes a declaration under section 132(4) on the earning of income not disclosed in respect of P.Y.2015-16 and P.Y.2016-17. Can that statement save the tax payer from a levy of penalty, if he is yet to file his return of income for A.Y.2016-17?

Answer

As per section 271AAB, penalty leviable on undisclosed income found during the course of a search, which has been initiated on or after 1st July, 2012, which relates to specified previous year, i.e.-

(1) the previous year which has ended before the date of search, but the due date of filing return of income for the same has not expired before the date of search and the return has not yet been furnished (i.e., P.Y.2015-16, in this case);

(2) the previous year in which search is conducted (i.e., P.Y.2016-17, in this case),

shall be:

(1) penalty@10%, if undisclosed income **is admitted during the course of search** in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be) and furnishes the return of income for the specified previous year declaring such undisclosed income.

(2) 20%, if undisclosed income relating to the specified previous year is **not admitted during the course of search** in the statement furnished under section 132(4) **but the same is disclosed in the return of income** filed after the date of search and the tax along with the interest, if any, is paid before the specified date

(3) in all other cases, penalty is leviable @ 60% of undisclosed income would be attracted.

Therefore, even if the assessee furnishes the statement under section 132(4), penalty @10% of undisclosed income of the specified previous year would be attracted under section 271AAB.

Note: *If the search is initiated on or after the date on which the Taxation Laws (Second Amendment) Bill, 2016 receives the assent of the President, penalty@30% would be attracted in a case where undisclosed income is admitted during the course of search in a statement furnished under section 132(4). In any other case, penalty@60% of undisclosed income would be attracted. The Taxation Laws (Second Amendment) Bill, 2016 has been passed by the Lok Sabha on 29.11.2016.*

Question 8

Cash of ₹ 25 lacs was seized on 12.9.2016 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.2016 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on, the following issues:

(i) Can the department withhold the explained money?

(ii) If yes, then to what extent and upto what period?

Answer

The proviso to section 132B(1)(i) provides that where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset. 'Existing liability', however, does not include advance tax payable. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within the 30 day period the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

Note: *It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the asset (in this case, cash) cannot be released, since the condition mentioned above is not satisfied.*

Question 9

The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 by the DDI, Delhi. The search was concluded on 9.8.2016 and following were also seized besides other papers and records:

(i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

(ii) Jewellery worth ₹ 5 lacs from the bed room of one of the director, which was claimed by him to be of his married daughter.

(iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.2012 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

(a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

(b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?

(c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?

(d) Proceedings for how many years shall now be taken up and within which time limit the assessment thereof be completed by the Assessing Officer?

(e) Can the company move an application for settlement of case as per Chapter XIX-A of the Act?

Answer

(a) The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.

(b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belongs to that person.

(c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.

(d) The search was conducted after 31.05.2003 and therefore, as per provisions of section 153A, the Assessing Officer will issue notices to the company to furnish the return of income in respect of each assessment year falling within six assessment years immediately preceding the assessment year relevant to the previous year in which the search is conducted. The date of search as 09.08.2016, notices for A.Y. 2011-12 to 2016-17 shall be issued by the Assessing Officer.

The assessment for six assessment years shall be completed [as per provisions of section 153B(1)(a)] within a period of 21 months from the end of the financial year in which the last of the authorisation for search was executed. Therefore, the assessment for the six assessment years shall be required to be completed by the Assessing Officer by 31.12.2018 as the search was concluded on 9.08.2016.

(e) As per clause (iiia) in the *Explanation* to section 245A, the assessee can approach the Settlement Commission at any time after the date of issue of notice under section 153A or section 153C initiating the assessment proceedings. Therefore, an application can be made to the Settlement Commission where search has been initiated under section 132 followed by assessment under section 153A or section 153C.

The proviso to section 245C(1) specifies the monetary limit for making application for settlement of cases, in respect of search cases. Accordingly, the additional amount of income-tax payable on the income disclosed in the application must exceed ₹ 50 lacs so that application for settlement of the case is eligible for admission.

Question 10

In the course of search on 25.03.2017, assets were seized. State the procedure laid down to deal with such seized assets under the Act.

Answer

Section 132B of the Income-tax Act, 1961 deals with the application of assets seized under section 132. Such assets will be first applied towards the existing liability under the Income-tax Act, 1961, etc. 'Existing liability', however, does not include advance tax payable. Further, the amount of liability determined on completion of search assessment (including any penalty levied or interest payable in connection with such assessment) and in respect of which the assessee is in default or deemed to be in default, may be recovered out of such assets.

Where the nature and source of acquisition of such seized assets is explained to the satisfaction of the Assessing Officer, the amount of any existing liability mentioned in para 1 above may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be. The release must be made within 120 days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A was executed. The assets would be released to the person from whose custody they were seized.

When the assets consist of solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in para 1 above and the assessee shall be discharged of such liability to the extent of the money so applied. However, the assets other than money may also be applied for the discharge of such liabilities if the complete recovery could not be made from the money seized or the money seized was not sufficient.

Question 11

The Assessing Officer issued notices under section 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer under the Income-tax Act, 1961. Discuss the correctness of action of the bank in refusing to furnish the particulars as required by the Assessing Officer.

Answer

As per section 133(6), power is given to an Assessing Officer to issue notice, for the purposes of the Act, requiring any person, including a banking company, to furnish information in respect of such points or matters or to furnish statement of accounts and affairs verified in the manner specified by the Assessing Officer, as may be useful for, or relevant to, *any enquiry or* *proceeding* under the Act. Therefore, the provisions of this section can be invoked even in case of any enquiry and it is not necessary that any proceeding should be pending against the customer for the same.

However, in respect of an enquiry, this power can be exercised by any Income-tax authority below the rank of Principal Director or Director or Principal Commissioner or Commissioner only after getting the prior approval of the Principal Director or Director or Principal Commissioner or Commissioner, as the case may be.

Therefore, the Assessing Officer can issue notice under section 133(6) asking for particulars relating to a customer in the specified format duly verified in the prescribed manner from the banking company, even if no proceeding is pending against such customer, provided he has obtained the prior approval of the Principal Director or Director or the Principal Commissioner or Commissioner, as the case may be.

Hence, in such a case, the action of bank in refusing to provide the particulars relating to a customer as required by the Assessing Officer on the ground that no proceeding was pending against the customer, is not correct.

Question 12

The Assessing Officer within his jurisdiction surveyed a popular Cyber Café at 12 o'clock in night for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The Cyber Café is kept open for business every day between 2 p.m. and 2 a.m. The owner of the Cyber Café claims that the Assessing Officer could not enter the café in late night. The Assessing Officer wanted to take away with him the books of account kept at the Cyber Café. Examine the validity of the claim made by the owner and the proposed action of the Assessing Officer.

Answer

The Assessing Officer can exercise his power of survey under section 133A only after obtaining the approval of the Joint Commissioner or Joint Director, as the case may be. Assuming that he has obtained such approval in this case, he is empowered under section 133A to enter any place of business of the assessee within his jurisdiction only during the hours at which such place is open for the conduct of business.

In the case given, the cyber cafe is open from 2.00 p.m. to 2.00 a.m. for the conduct of business. The Assessing Officer entered the cyber cafe at 12 o'clock in the night which falls within the working hours of the cyber cafe. Therefore, the claim made by the owner to the effect that the Assessing Officer could not enter the cyber cafe at late night is not in accordance with law.

Further, as per section 133A(3)(ia), the Assessing Officer may, impound and retain in his custody for such period as he thinks fit, any books of account or other documents inspected by him. However, he shall not impound any books of account or other documents except after recording his reasons for doing so. He shall not retain in his custody any such books of account or other documents for a period exceeding fifteen days (exclusive of holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner or Principal Director or Director therefor, as the case may be.

Question 13

An Assessing Officer entered a hotel run by a person, in respect of whom he exercises jurisdiction, at 8 p.m. for the purpose of collecting information, which may be useful for the purposes of the Act. The hotel is kept open for business every day between 9 a.m. and 9 p.m. The hotelier claims that the Assessing Officer could not enter the hotel after sunset.

The Assessing Officer wants to take away with him the books of account kept at the hotel.

Examine the validity of the claim made by the hotelier and the proposed action of the Assessing Officer with reference to the provisions of section 133B of the Income-tax Act, 1961.

Answer

Section 133B(2) of the Income-tax Act, 1961 empowers an income-tax authority to enter any place of business during the hours at which such place is open for the conduct of business. The hotel is open from 9.00 a.m. to 9.00 p.m. for the conduct of business. The Assessing Officer entered the hotel at 8.00 p.m. which falls within the working hours. The claim made by the hotelier to the effect that the Assessing Officer could not enter the hotel after sunset is not in accordance with law.

Section 133B(3) provides that an income tax authority acting under this section shall, on no account, remove or cause to be removed from the place wherein he has entered, any books of account. In view of this clear prohibition in section 133B(3), the proposed action of the Assessing Officer to take away with him the books of account kept at the hotel is not valid in law.

Question 14

A Co-operative society engaged in banking business received a letter from the Assistant Commissioner of Income-tax (ACIT), to furnish details of all persons who have made time deposit of ₹ 1 lakh or above during the period from 1.4.2016 to 31.3.2017.

There is no pending proceeding against the Co-operative society at the time of receipt of letter.

As a Chartered Accountant, what would be your advise to the cooperative society regarding legality of the notice?

Answer

The issue under consideration is whether, in a case where no proceeding is pending against a person, can the Assessing Officer call for information. It is assumed that such details were sought for under section 133(6) of the Income-tax Act, 1961.

The facts of the case are similar to the facts in *Kathiroor Service Co-operative Bank Ltd. v. CIT (CIB) (2014) 360 ITR 0243*, wherein the above issue came up before the Supreme Court.

The Supreme Court observed that the Assessing Officer has been empowered to requisition information which will be useful for or relevant to any enquiry or proceeding under the Income-tax Act, 1961 in the case of any person[1].

However, an income-tax authority below the rank of the Principal Director/Director or Principal Commissioner/Commissioner can exercise this power in respect of an enquiry in a case where no proceeding is pending, only with the prior approval of the Principal Director/Director or the Principal Commissioner/Commissioner.

Information of general nature could be called for from banks. In this case, if the letter/notice been issued after obtaining approval of the competent higher authorities mentioned above, the Assistant Commissioner of Income-tax (ACIT) has not erred in issuing letter/notice to the co-operative society requiring them to furnish information regarding persons who have made time deposits of ₹ 1 lakh or more. For such enquiry under section 133(6), letter/notice could be validly issued by ACIT, after obtaining the approval of Principal Director/Director/Principal Commissioner/Commissioner.

If prior approval of the competent higher authority is not obtained, the co-operative society can contest the validity of the notice issued. The co-operative society should furnish a preliminary reply to the ACIT stating that it would furnish the necessary details sought for, when it is assured by the ACIT that the necessary approvals of higher authorities has been obtained.

The advice to the co-operative society needs to be framed on the above lines.

Exercise

1. *An income-tax authority, in the course of exercise of powers of survey under section 133A, serves summon on the assessee and impounds the books of account and other documents found in the premises visited. Discuss the legality of the action.*
2. *Certain assets were seized in the course of search on 4.5.2016. State the procedure laid down to deal with such assets seized under the Act.*
3. *What are the presumptions which can be made if any books of account, document, money, bullion, jewellery are found in possession of a person in the course of a search?*

[1] Second proviso to section 133(6)

4. *What are the circumstances under which an authorization under section 132 can be issued?*
5. *Is it possible to retain seized books and other documents beyond a period of 30 days? Is so, what are the conditions to be fulfilled in this regard?*
6. *Explain the manner of utilization of the assets seized.*
7. *Write short notes on the following powers of an income-tax authority -*
   - *(a) Power to call for information*
   - *(b) Power to make enquiry*

21

Assessment Procedure

Question 1

Teachwell Education is a trust approved under section 10(23C)(vi) which runs various educational institutions. During the course of assessment under section 143(3), the Assessing Officer finds that the trust has carried out its activities in contravention of the section under which it was approved for exemption. Hence, the Assessing Officer wants to pass an order without giving exemption under section 10, which the assessee objects. You are required to examine the following with respect to the provisions of Income-tax Act, 1961.

(a) Whether the Assessing Officer can pass an order without giving exemption under section 10?

(b) Can the Assessing Officer get any additional time limit in completing this assessment?

Answer

(a) As per the first proviso to section 143(3), in the case of an institution approved under, *inter alia*, section 10(23C)(vi), which is required to furnish the return of income under section 139(4C), the Assessing Officer shall not pass an order of assessment under section 143(3) without giving effect to the provisions of section 10, unless he is of the view that the activities of the institution are being carried on in contravention to the provisions of that section and:

(1) he has intimated the Central Government or the prescribed authority, which had earlier approved the concerned institution, about the contravention of the relevant provisions by the institution; and

(2) the approval granted to such institution has been withdrawn or notification in that respect has been rescinded.

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), only if he has intimated the contravention made by Teachwell Education to the Central Government or the prescribed authority, as the case may be, and its approval under section 10(23C)(vi) is withdrawn.

(b) As per *Explanation 1* to section 153, in case the Assessing Officer intimates the contravention of provisions of section 10(23C)(vi) to the Central Government or the prescribed authority, the period commencing from the date of intimation of such contravention by the Assessing Officer and ending on the date on which the copy of the order of withdrawing the approval under section 10(23C)(vi) is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion, is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.

Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.

Question 2

State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2017-18:

(i) Mr. X, a resident individual, aged 80 years, has a total income of ₹ 2,85,000. He has claimed deduction of ₹ 1,50,000 under section 80C and exemption of ₹ 1,20,000 under section 10(38).

(ii) ABC, a partnership firm, has a loss of ₹ 10,000 during the previous year 2016-17.

(iii) A registered association, eligible for exemption under section 10(23B), has income from house property of ₹ 2,60,000.

(iv) Mr. Y, aged 45 years, an employee of ABC (P) Ltd, draws a salary of ₹ 4,90,000 and has income from fixed deposits with bank of ₹ 10,000.

Answer

S. No.	Is filing of return required?	Reason
(i)	**Yes**	As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of, Chapter VI-A and exemption under section 10(38) exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. X before giving effect to the exemption of ₹ 1,20,000 under section 10(38) and deduction of ₹ 1,50,000 under section 80C is ₹ 5,55,000, which exceeds the basic exemption limit of ₹ 5,00,000 applicable to an individual aged 80 years or more. Therefore, Mr. X has to furnish his return of income for the A.Y. 2017-18.
(ii)	**Yes**	As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y. 2017-18 on or before the due date.

(iii)	**Yes**	As per section 139(4C), every institution referred to, *inter alia*, in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. In the above case, the registered association has income from house property of ₹ 2,60,000 before exemption under section 10, which exceeds the basic exemption limit of ₹ 2,50,000. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2017-18.
(iv)	**Yes**	As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. Y is ₹ 5,00,000 (₹ 4,90,000 + ₹ 10,000) which exceeds the basic exemption limit of ₹ 2,50,000 applicable to an individual. Therefore, Mr. Y has to furnish his return of income for the A.Y. 2017-18.

Question 3

The Assessing Officer issued a notice under section 142(1) on the assessee on 24th December, 2016 calling upon him to file return of income for Assessment Year 2016-17. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.

Answer

As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried forward and set-off under*, inter alia*, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 73AC or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity or owning and maintaining race horses) or section 73A (loss relating to a "specified business") However, there is no such condition for carry forward of unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, the return filed by the assessee in response to notice under section 142(1) is a belated return and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) or section 73A shall not be available. The assessee shall, however be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

Question 4

The regular assessment of MNO Ltd. for the Assessment Year 2015-16 was completed under section 143(3) on 13th March, 2017. There was an audit objection by the Revenue Audit team that interest on loan should be disallowed partly as there was diversion of borrowed fund to sister concern without charge of interest.

Based on the above facts:

(i) State, with reasons, whether the Assessing Officer can issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

(ii) If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection?

Answer

(i) Section 147 states that if the Assessing Officer has **reason to believe that any income chargeable to tax has escaped assessment for any assessment year**, he may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The Assessing Officer should, therefore, have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not of the revenue audit team.

Further, the Income-tax Act, 1961 does not confer jurisdiction on the Assessing Officer to change its opinion on the interpretation of a particular provision earlier adopted by it. If the issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different view.

Therefore, the Assessing Officer cannot issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

If the Assessing Officer has acted only under compulsion of the audit party and not independently, the action of reopening would be invalid.

(ii) The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records, if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. It was so held in *CIT vs. Sohana Woollen Mills (2008) 296 ITR 238 (P & H).*

Mere audit objection and possibility of a different view are not sufficient to conclude that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

Question 5

State whether the following assessees have to file return of income and if so, the due date for the assessment year 2017-18:

(i) A registered trade union having income from let out property of ₹ 1,00,000.

(ii) A public trust hospital having an aggregate annual receipt of ₹ 200 lacs and availing exemption under section 10(23C)(via) with total income of ₹ 1,10,000.

Answer

(i) A registered trade union is having income from property, which is exempt under section 10(24).

Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of section 10. Even without giving effect to section 10(24), the total income is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.

(ii) The quantum of exemption under section 10(23C)(via) is not given in the question.

If the total income of the public trust hospital, without giving effect to the exemption under section 10(23C)(via), is less than the basic exemption limit of ₹ 2,50,000, the trust need not file its return of income. However, if the total income without giving effect to the exemption under section 10(23C)(via) exceeds ₹ 2,50,000, the trust has to file its return of income by 30th September, 2017.

Question 6

Dishant received a notice under section 148 from the Assessing Officer for A.Y. 2013-14 on the ground that depreciation on certain assets was allowed in excess. The Assessing Officer recorded the reason for reopening. The original assessment was completed under section 143(3). In course of reassessment proceeding, the Assessing Officer also disallowed certain sum under section 14A in respect of expenses purported to be in relation to dividend from companies and tax-free interest. However, the Assessing Officer did not record the reason for applying the provisions of section 147 in respect of the issue of disallowance under section 14A and passed the order disallowing the excess depreciation and also certain sum under section 14A. Is there any infirmity in the order passed by the Assessing Officer?

Answer

Explanation 3 to section 147 permits the Assessing Officer to assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under section 147, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2).

Hence, there is no deficiency in the order passed by the Assessing Officer.

Question 7

In the proceedings initiated under section 153A, the assessment order passed in respect of Mr. Simbu pertaining to a particular assessment year was annulled by the Income-tax Appellate Tribunal in its order passed on 28.1.2017. The same was received on 28.2.2017 by the jurisdictional Commissioner of Income-tax. Does the Department have any power to complete the assessment subsequent to such annulment? If yes, within what time limit?

Answer

As per section 153A(2), if any proceedings initiated under section 153A or any order of assessment or reassessment made under section 153A(1) has been annulled in any appeal or other legal proceeding, the abated assessment or reassessment relating to any assessment year shall stand revived with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner. If the order of annulment is set aside, such revival shall cease to have effect [Sub-section (2) of section 153A].

The time limit for completion of such assessment or reassessment shall be one year from the end of the month in which the abated assessment revives or within the period already specified in section 153B(1), whichever is later.

Question 8

What will be the consequences when Mr. Raghav made payment of ₹ 75,000 in cash to a travel agent for his travel to Saudi Arabia to be undertaken for business purposes by quoting intentionally the wrong PAN? Would your answer be different if such cash payment was made for his travel to Nepal, instead of Saudi Arabia?

Answer

If a person who is required to quote his permanent account number in any document referred to in section 139A(5)(c), quotes a number which is false, and which he either knows or believes to be false or does not believe to be true, the Assessing Officer may direct that such a person shall pay by way of penalty a sum of ₹ 10,000 under section 272B(2).

In the given case, if Mr. Raghav travels to Saudi Arabia and pays his travel agent cash in excess of ₹ 50,000, such a transaction is covered by section 139A(5)(c) read with Rule 114B and therefore, Mr. Raghav has to quote his PAN. Since Mr. Raghav has misquoted his PAN, penalty under section 272B(2) is leviable. Mr. Raghav has to be given an opportunity of being heard in the matter. If Mr. Raghav is not able to prove that there was a reasonable cause for the said failure, penalty under section 272B(2) would be imposable.

The answer would remain the same even if such cash payment was made for his travel to Nepal.

Question 9

For facilitating expeditious resolution of disputes relating to international transactions involving transfer pricing and foreign companies, the Income-tax Act, 1961, has provided for "alternate dispute resolution mechanism". In this context, you are required to answer the following:

(i) What meanings have been assigned to "dispute resolution panel" and the "eligible assessee" under this mechanism?

(ii) When can a grievance for resolution be filed by an assessee?

(iii) What evidences are being considered by the panel to redress the grievance of the assessee?

Answer

(i) The term "Dispute Resolution Panel" has been defined to mean a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the Board for this purpose.

The term "Eligible Assessee" means any person in whose case the variation referred to in section 144C(1) in the income or loss returned arises as a consequence of the order of the Transfer Pricing Officer passed under section 92CA(3) and any foreign company.

(ii) The Assessing Officer shall forward a draft of the proposed order of assessment to the eligible assessee and on receipt of such order, the eligible assessee shall, within thirty days of the receipt of the draft order, file his acceptance of the variations to the Assessing Officer or file his objections, if any, to such variation, with the Dispute Resolution Panel and the Assessing Officer.

(iii) The Dispute Resolution Panel shall, in a case where any objections are received, take into consideration:-

(a) the draft order

(b) the objections filed by the assessee

(c) the evidence furnished by the assessee

(d) the report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority

(e) the records relating to the draft order

(f) the evidence collected by, or caused to be collected by it

(g) the result of any enquiry made by or caused to the made by it,

and issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

Question 10

The Assessing Officer has the power to make an assessment to the best of his judgment, in certain situations. What are they?

Answer

Under section 144, the Assessing Officer, after taking into account all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee in the following cases –

(1) Where any person fails to make the return under section 139(1) and has not filed a belated return under section 139(4) or a revised return under section 139(5).

(2) Where any person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited.

(3) Where any person, having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Further, section 145(3) of the Income-tax Act, 1961 permits the Assessing Officer to make an assessment in the manner provided in section 144:

(i) where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or

(ii) where the method of accounting under section 145(1) has not been regularly followed by the assessee;

(iii) where the income has not been computed in accordance with "Income Computation and Disclosure Standards" notified by the Central Government under section 145(2).

Question 11

The assessment of CNK Associates, a partnership firm for the assessment year 2014-15 was made under section 143(3) on 31st July, 2016. The Assessing Officer made two additions to the income of the assessee viz. (a) addition of ₹ 2 lacs under section 40(a)(ia) due to non-furnishing of evidence of payment of TDS and (ii) addition of ₹ 5 lacs on account of unexplained cash credit. The assessee contested addition on account of unexplained cash credit in appeal to the Commissioner (Appeals). The appeal was decided in January, 2017 against the assessee. The assessee approaches you for your suggestion as to whether it should apply for revision to the Commissioner under section 264 or rectification to the

Assessing Officer under section 154 as regards disallowance under section 40(a)(ia). What should be your suggestion?

Answer

The Commissioner cannot exercise his power of revision under section 264 where the order sought to be revised has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal [Section 264(4)], even if the relief claimed in the revision is different from the relief claimed in the appeal. This was the view of the Supreme Court in the case of *Hindustan Aeronautics Limited vs. CIT (2000) 243 ITR 808 (SC).* It is not open to the assessee to seek recourse to revision under section 264 after the appeal is decided. Therefore, although the matter of addition of ₹ 2 lacs under section 40(a)(ia) was not taken before the Commissioner (Appeals), the assessee, CNK Associates cannot apply for revision under section 264 in respect of the same.

Under section 154(1A), where any matter had been considered and decided in any proceeding by way of appeal or revision, rectification of such matter cannot be done by the Assessing Officer. However, in respect of the matter which has not been considered and decided in the appeal or revision, the order of the Assessing Officer can be rectified under section 154. Thus, the assessee can apply to the Assessing Officer for rectification of the order in respect of addition under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision.

In view of above, the assessee, CNK Associates should seek rectification under section 154.

Question 12

Examine critically in the context of provisions of the Act "Can the Assessing Officer issue notice under section 148 to reopen the same assessment order on the same grounds for which the CIT had issued notice under section 263 of the Act"?

Answer

The Assessing Officer cannot issue notice under section 148 to reopen the same assessment order on the same grounds for which the Commissioner had issued notice under section 263 of the Income-tax Act, 1961, since the third proviso to section 147 specifically provides that the Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, if the income relates to a matter which is the subject matter of revision under section 263, then the Assessing Officer cannot issue notice under section 148 to reopen the assessment order.

Question 13

Is the Assessing Officer empowered to assess or reassess an income which is chargeable to tax and has escaped assessment, in a case which is pending before the Appellate Tribunal? Discuss.

Answer

As per third proviso to section 147, the Assessing Officer may assess or reassess an income which is chargeable to tax and which has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, in respect of the matters which are the subject matter of an appeal before the Appellate Tribunal, it is not possible for the Assessing Officer to initiate proceeding under section 147. However, in respect of other matters, which are not the subject matter of the appeal, the Assessing Officer can initiate proceeding under section 147.

Question 14

A search was conducted under section 132 in the business premises of Harish on 15th December, 2016. At that time, assessments under section 143(3) for A.Y. 2014-15 and A.Y. 2015-16 and reassessment proceeding under section 147 for A.Y. 2013-14 were pending before the Assessing Officer.

(i) What are the assessment years for which notice can be issued for making post-search assessment?

(ii) What would be the fate of pending assessments and reassessment?

(iii) What would be the effect, if the post-search assessment orders are annulled by the Income-tax Appellate Tribunal?

Answer

(i) The notice under section 153A can be issued for six assessment years preceding the assessment year relevant to the previous year in which the search is conducted. In this case, the search is conducted in the previous year 2016-17, the relevant assessment year for which is A.Y.2017-18. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2011-12 to 2016-17.

(ii) As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years, pending on the date of initiation of the search under section 132, shall abate. In other words, they will cease to be applicable. Therefore, the assessments under section 143(3) for assessment years 2014-15 and 2015-16 and the reassessment proceeding under section 147 for assessment year 2013-14 **shall abate.**

(iii) Section 153A provides that where the post-search assessment order is annulled in any appeal or any other legal proceeding, the abated assessment and reassessment proceedings shall stand revived. Therefore, the assessments under section 143(3) relating to assessment years 2014-15 and 2015-16 and the reassessment proceeding relating to assessment year 2013-14, which abated on initiation of search, **shall stand revived**.

Question 15

Does the Assessing Officer have power to make any adjustment to income disclosed by the assessee in the return of income in course of processing the return under section 143(1)?

Answer

The procedure to be followed for summary assessment is contained in section 143(1). As per section 143(1), the total income or loss of an assessee shall be computed after making the following adjustments to the returned income:

(i) any arithmetical error in the return; or

(ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

(iii) disallowance of loss claimed, if return is filed beyond due date u/s 139(1)

(iv) disallowance of expenditure indicated in the audit report but not taken into account in computing the total income in the return

(v) disallowance of deduction claimed under section u/s 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or 80-IE, if return is filed beyond due date u/s 139(1)

(vi) addition of income appearing in Form 26AS or Form 16A/16 which has not been included in computing the total income in the return

No such adjustment shall be made unless as intimation is given to the assessee of such adjustment either in writing or electronic mode. Further, Assessing Officer shall make any adjustment after considering the response received from the assessee, if any. Where no response is received with 30 days of the issue of such notice, the above adjustment can be made.

For the purpose of section 143(1), "an incorrect claim apparent from any information in the return" means such claim on the basis of an entry, in the return of income:

(i) of an item, which is inconsistent with another entry of the same or some other item in such return;

(ii) in respect of which, the information required to be furnished under the Income-tax Act, 1961 to substantiate such entry, has not been so furnished;

(iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage or ratio or fraction.

Question 16

Can the Assessing Officer complete the assessment of income from international transactions in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of the assessee?

Answer

Section 92CA(4) provides that the order of the Transfer Pricing Officer determining the arm's length price of an international transaction is binding on the Assessing Officer and the

Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer and on the basis of contention raised by the assessee.

Question 17

Tai Ltd. filed its return of income for assessment year 2016-17 on 6th June, 2016. The return is selected for regular assessment under section 143(3) for which notice under section 143(2) is served on the company on 3rd October, 2017. The company responded to the notice under section 143(2). State whether the service of the notice is within time and if not, whether the assessment order can be challenged by the assessee.

Answer

The time limit for service of notice under section 143(2) is six months from the end of the financial year in which the return of income was furnished by the assessee. The return of income for assessment year 2016-17 was filed by the assessee on 6^{th} June, 2016. Therefore, the notice under section 143(2) has to be served by 30^{th} September, 2017. However, the notice was served on the assessee only on 3^{rd} October, 2017. Hence the notice issued under section 143(2) is time-barred.

However, as per section 292BB, where an assessee had appeared in any proceedings or co-operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner. However, the above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment. Therefore, in the instant case if the assessee, Tai Limited, had raised an objection to the proceeding, on the ground of non-service of the notice under section 143(2) upon it on time, then the validity of the assessment order can be challenged. In absence of such objection, the assessment order cannot be challenged.

Question 18

In the case of Mr. Rajesh, a summary assessment was made under section 143(1) for assessment year 2013-14 without calling him. Thereafter, Mr. Rajesh has received a notice under section 148 on 6th April, 2016 for reopening of assessment. Can Mr. Rajesh challenge the legality of the notice on the ground of change of opinion?

Answer

Under the scheme of section 143(1), only the adjustments relating to any arithmetical error in the return, incorrect claim which is apparent from any information in the return, disallowance of losses claimed where the relevant return of income was filed beyond the due date under section 139(1), disallowance of expenditure indicated in the audit report but not taken into account in computing total income in the return, disallowance of deduction claimed under section 10AA, sections 80-IA to 80-IE, where return is furnished beyond due date and addition of income appearing in Form 26AS or Form 16 or Form 16A which has not been included in computing the total income in the return are permitted. In short, what is permissible is only correction of errors apparent on the basis of the of the return and tax audit report filed as well as Form 26AS, Form 16 or Form 16A. Therefore, the intimation given under section 143(1) is only a preliminary assessment, commonly referred to as a summary assessment without calling the assessee. The same cannot be treated as an order of assessment under section 143(3). Since there has been no assessment under section 143(3) in this case, the question of change of opinion does not arise.

Therefore, the assessee cannot challenge the legality of the notice issued under section 148 reopening the assessment on the ground of change of opinion in a case where no assessment is made under section 143(3). This inference is supported by the Supreme Court ruling in *ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd. (2007) 291 ITR 500.*

Question 19

Discuss the correctness or otherwise of the following proposition in the context of the Income-tax Act, 1961:

A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise.

Answer

This proposition is correct. A return of income filed within the due date under section 139(1) or a belated return filed under section 139(4) may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act, 1961, to make changes or modification in the return of income by filing a letter. The revised return can be filed at any time before the expiry of 1 year from the end of the relevant assessment year or before completion of assessment, whichever is earlier. In a case where a return of income has been filed within the due date under section 139(1) or after the due date under section 139(4), the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court in *Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323* has held that there is no provision in the Income-tax Act, 1961 to allow an amendment in the return of income filed except by way of filing a revised return.

Question 20

The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order". Decide the correctness of the action of the Assessing Officer.

Answer

As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

Therefore, in this case, the order of the Assessing Officer is not valid, since the assessee was not given an opportunity of being heard prior to passing of such order.

Question 21

Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had a total income of ₹ 6,00,000 from this business which was her only source of income during the year ended on 31.3.2017. She consults you to have an opinion whether she is required to file return of income for the A.Y. 2017-18 as per provisions of section 139(1).

Answer

The clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income-tax Rules, 1962 is given in *Circular No.10/2006 dated 16.10.06*. According to Rule 7B, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory, would not be required to file the return of income if the aggregate of 40% of his or her income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income under all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of ₹ 6,00,000 from this business, which was her only source of income for P.Y.2016-17. 40% of her total income works out to ₹ 2,40,000, which is less than the basic exemption limit of ₹ 2,50,000 in respect of an individual assessee. Therefore, Smt. Kanti is not required to file a return of income for the A.Y.2017-18 as per the provisions of section 139(1).

Question 22

Ram, an individual, filed his return of income for the assessment year 2016-17 on 15.6.2016. He later discovered that he had not claimed deduction under section 80C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The

Assessing Officer completed the assessment without allowing the deduction claimed by Ram. Is the Assessing Officer justified in doing so?

Answer

The Supreme Court has, in *Goetze (India) Ltd. v. CIT (2006) 284 ITR 323,* ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, Ram has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

Question 23

Examine the correctness or otherwise of the following statements in the context of provisions contained in the Income-tax Act, 1961 and the decided case laws:

"The Assessing Officer is bound to allow the set-off of brought forward losses under section 72 even if the assessee has not claimed the same in the return filed".

Answer

The statement is correct.

The Supreme Court has, in *CIT v. Mahalakshmi Sugar Mills Co. Ltd. (1986) 160 ITR 920,* held that it is the duty of the Assessing Officer to apply the relevant provisions of the Act for the purpose of determining the true figure of the assessee's total income and consequential tax liability. Merely because the assessee has not claimed the set-off in the return filed, it cannot relieve the Assessing Officer of his duty to apply section 72 in the appropriate case.

As per *CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955*, it is the duty of the Assessing Officer to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard, they should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.

Therefore, on the basis of the above Supreme Court ruling and the CBDT Circular, the Assessing Officer is bound to allow the set-off of brought forward losses under section 72, even if the assessee has not claimed the same in the return filed, provided the loss was determined in pursuance of a return filed under section 139(3) in any earlier previous year.

Moreover, the wording used in section 72 is "shall", indicating that the provisions relating to set off of brought forward business loss are mandatory.

Therefore, the Assessing Officer is bound to allow the claim for set off of brought forward business losses even if the assessee has not claimed the same in the return filed.

Question 24

X, an individual, has got his books of account for the year ending 31.3.2017 audited under section 44AB. His total income for the assessment year 2017-18 is ₹ 2,60,000. He desires to know if he can furnish his return of income for the assessment year 2017-18 through a Tax Return Preparer.

Answer

Section 139B provides for submission of return of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of 'specified class or classes of persons' and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of X for the year ending 31.3.2017 have been audited under section 44AB. As such, he cannot furnish his return of income for the assessment year 2017-18 through a Tax Return Preparer.

Question 25

T, an individual, filed his return of income for the assessment year 2017-18 on 18.10.2017 declaring a total income of ₹ 1,20,000. He later discovered that he had not claimed a particular deduction amounting to ₹ 2,10,000 while computing his business income in the said return. He filed a revised return on 03.01.2019 declaring a total loss of ₹ 90,000. The Assessing Officer proposes to disallow the claim of T for carry forward of the business loss under section 72(1) amounting to ₹ 90,000 for the reason that the revised return declaring loss for the first time was filed beyond the time prescribed under section 139(3). Examine the validity of the proposed action of the Assessing Officer.

Answer

T has filed his original return of income for the assessment year 2017-18 within the due date specified in section 139(4) for filing a belated return i.e., on or before 31.3.2018. Section 139(5) empowers an assessee, who discovers any omission or wrong statement in the return filed by him under section 139(1) or 139(4), to file a revised return before the expiry of the one year from the end of relevant assessment year or before the completion of the assessment, whichever is earlier. T, having discovered an omission to claim a particular deduction in the return filed by him belated under section 139(4), has filed a revised return within the time prescribed under section 139(5), i.e., on or before 31.3.2019. A revised return has the effect of replacing the original return and relates back to the date of the original return. Thus, where a return was filed under section 139(4) declaring income and later it was revised declaring a loss, the revised return shall substitute the original return which was filed belatedly. However, for carry forward of business loss under section 72(1), the original return should have been filed on or before the due date under section 139(1). In this case, since the original return was filed belatedly under section 139(4), and was subsequently revised under section 139(5), the revised return would replace the belated return. Hence, carry forward of losses on the basis of a revised return which replaces the return filed belatedly, is not permitted. Therefore, the proposed action of the Assessing Officer to deny the benefit of carry forward of business loss to T is valid in law.

Question 26

EIH Private Ltd's assessment for assessment year 2011-12 was completed under Section 143(3) on 31st August, 2012. The company went in appeal to the Commissioner (Appeals) and the appeal was decided on 16th August, 2013 and the appeal effect was duly given by the Assessing Officer on 25th August, 2013. Thereafter, on 1st September, 2017 the Assessing Officer noticed a mistake in calculation of depreciation on a particular block of assets, which reduced the income excessively by ₹ 1.10 lacs. The Assessing Officer issued notice under section 154 for the purpose of rectifying the mistake. Is such rectification permissible?

Answer

Any rectification order under section 154 has to be passed within 4 years from the end of financial year in which the order sought to be amended was passed. Order sought to be amended does not necessarily mean the original order. It could be any order including the amended or rectified order. Where any matter has been considered and decided in any proceeding by way of appeal or revision, the authority passing such order may amend the order in relation to any matter other than the matter which has been so considered and decided.

For subsequent rectification, the time limit of 4 years shall be from the end of the financial year in which the earlier rectification order was passed. *[Hind Wire Industries Ltd vs. CIT (1995) 212 ITR 639 (SC)].* In the given case, the time limit of 4 years has to be reckoned from the end of the financial year in which the order giving effect to the CIT(Appeal)'s decision was passed. Therefore, the rectification order can be passed by the Assessing Officer at any time before expiry of 4 years from the end of the financial year 2013-14 i.e. on or before 31st March, 2018. In this case, the mistake was noticed by the Assessing Officer on 1st September, 2017, for which he issued notice under section 154 for rectifying the mistake. Such rectification is permissible as the time limit of 4 years expires only on 31st March, 2018.

Question 27

A company submitted the return of income for assessment year 2015-16 on 10th October, 2015. The Assessing Officer served a notice under section 143(2) on the company on 14th September, 2016 in order to make assessment under section 143(3). Thereafter, on 3rd April, 2017, the Assessing Officer issued intimation under section 143(1). Such intimation shows a demand for ₹ 10,500 towards tax and interest. Discuss the correctness of the action of the Assessing Officer.

Answer

As per the provisions of section 143(1D), notwithstanding anything contained in section 143(1), the processing of a return under section 143(1) shall not be necessary before the expiry of one year from the end of the financial year in which the return is made, where a notice of assessment has been issued to the assessee under section 143(2) for scrutiny of the return.

However, the return has to be processed, before the issuance of an order of assessment under section 143(3). In this case, since the Assessing Officer has issued notice under section 143(2) before 30.9.2016, he can issue intimation under section 143(1) after 31.3.2017, being the expiry of one year from the end of financial year 2015-16, being the year in which the return was filed. Therefore, issue of intimation under section 143(1) on 3.4.2017 before issuance of order under section 143(3) is correct in law.

Question 28

(a) *J filed a return of income for the Assessment Year 2005-06, in due time disclosing a total income of ₹ 4 lacs. The taxes due on the income were covered by taxes deducted at source, advance tax and self-assessment tax.*

The return was taken for scrutiny by the Assessing Officer, who made large additions to the income disclosed by J. On appeal, the High Court set aside the order of assessment and directed a fresh assessment to be made after hearing the parties. The court order had become final since neither party had preferred an appeal against it.

The Assessing Officer did not make any fresh assessment with the result that the assessment became barred by time.

J has filed a petition that since no assessment of his income had been made by the Assessing Officer, the entire taxes paid, including the pre-assessment payments, must be refunded to him.

Is he justified in making this claim? Discuss.

(b) *An assessment was completed by the Assessing Officer under section 143(3) on the basis of return submitted and other information furnished by the assessee. The Assessing Officer accepted the cost of the land after waiting for a reasonable period for report of the valuation officer to whom a reference was made. Subsequent to receiving the report from the valuer, it revealed that there was a variation by about ₹ 3.00 lacs. On the basis of this valuation report, the Commissioner issued notice under section 263 to set aside the completed assessment.*

Justify the action of the Commissioner.

(c) *M filed return of income for Assessment Year 2015-16 claiming a refund of ₹ 45,000. The said refund was granted and paid to the assessee on 1st March, 2016 after processing the return under section 143(1). Later on, the case was taken up for regular assessment by issue of notice under section 143(2) and the said assessment was completed on 16th*

August, 2017 resulting in demand of ₹ 2500. Is the assessee liable to pay interest on the amount of refund already granted to him?

Answer

(a) The Gujarat High Court held, in *Saurashtra Cement and Chemical Industries Ltd. v. ITO (1992) 194 ITR 659,* that the liability to pay income-tax arose under section 4(1) of the Act and did not depend upon an assessment order being made by the Assessing Officer. It depends upon the enactment of the annual Finance Act laying down the rates of taxation for the relevant assessment year. Thus, as soon as the rates are prescribed, the liability to pay tax crystallizes.

On filing of return under section 139, the provisions of section 140A also get activated, since if any taxes over and above those paid by way of advance tax and tax deducted at source remain, payment has to be made under section 140A before a valid return of income could be filed by an assessee. Payment of pre-assessment taxes does not depend on an assessment being made by the Assessing Officer.

In the present case, J had paid taxes on the basis of his own declaration of income. J's primary liability under section 4 of the Act is not absolved merely due to absence of a formal assessment. As decided by the Supreme Court in *CIT v. Shelly Products (2003) 261 ITR 367*, pre-assessment taxes paid on the basis of admitted income do not become refundable in the absence of an assessment. Hence J's contention is incorrect.

(b) As per the facts of the case, the Assessing Officer completed the assessment before the valuation report was received. The valuation report was received subsequent to completion of the assessment. However, it may be noted that the said report forms part of the 'record', which the Commissioner may call for and examine under section 263(1). A perusal of the valuation report revealed a variation of ₹ 3 lacs and to that extent it can be said that the order of the Assessing Officer was prejudicial to the interests of Revenue and also erroneous. The Commissioner is absolutely justified in issuing notice under section 263 since the term "record" used in the said section includes all the records available at the time of examination by the Commissioner even though such records may not have been available at the time of regular assessment. This view was upheld by the Supreme Court in *CIT v. Shree Manjunathesware Packing & Camphor Works (1998) 231 ITR 53.*

(c) As per section 234D, where any refund is granted to the assessee after processing the return under section 143(1) and later on, in the regular assessment there is no refund due or the amount refunded exceeds the amount refundable, the assessee shall be liable to pay simple interest at ½% for every month or part of a month from the date of grant of refund to the date of such regular assessment on the whole or the excess amount so refunded.

In this case, the assessee was granted refund after processing the return under section 143(1) and upon regular assessment under section 143(3) it was found that nothing is refundable and the assessee had to pay ₹ 2,500 towards taxes. The assessee hence has to pay interest @ ½% per month or part of a month on the refund granted of ₹ 45,000 from the date of grant of refund to the date of regular assessment.

Question 29

The assessment for assessment year 2014-15 of XYZ Pvt. Ltd. was completed under section 143(3) by making additions and thus creating a demand. The company filed an appeal against this order before the CIT(A) and was allowed relief. However, this order of CIT(A) was challenged by the department and was reversed by the ITAT. In this context, explain the liability of the company as to payment of interest charged by the Assessing Officer from the date of order of CIT(A) till the date of order by the ITAT under section 220(2) in the following conditions:

(i) The tax demanded as per order was paid in full within the time allowed as per notice issued under section 156.

(ii) The tax demanded as per order was not paid.

Answer

(i) Where the tax demanded as per order was paid in full within the time allowed as per notice issued under section 156

Interest under section 220(2) would be attracted if there is a notice of demand under section 156 and there is a default in paying the amount so demanded within the time stipulated in the notice.

In this case, the company has paid the tax demanded as per the order in full within the time allowed as per the notice issued under section 156. Therefore, the company is not liable to pay interest under section 220(2) for the period from the date of order of CIT(A) to the date of order of ITAT.

This view finds support in the Supreme Court ruling in *Vikrant Tyres Ltd v. First ITO (2001) 247 ITR 821.*

(ii) Where tax demanded as per the order was not paid

Where the assessment made originally by the Assessing Officer is either varied or even set aside by one appellate authority but on further appeal, the original order of the Assessing Officer is restored either in part or wholly, the interest payable under section 220(2) will be computed with reference to the due date reckoned from the original demand notice. The fact that during an intervening period, there was no tax payable by the assessee under any operative order would make no difference to this position *[Girnar Investment Ltd v. CIT (2012) 340 ITR 529 (Del)].*

This position has been affirmed by the second proviso to section 220(2), which provides that if as a result of order of Commissioner (Appeals), the amount of interest payable was reduced, and thereafter, as a result of the order of Appellate Tribunal, the interest payable was increased, the assessee would be liable to pay interest under section

220(2) from the day immediately following the end of the period mentioned in the first notice of demand referred to in section 220(1) till the date on which the amount is paid.

Therefore, if the company has not paid the tax demanded as per the order within 30 days of service of the notice of demand under section 156, it shall be liable to pay simple interest @ 1% for every month or part of the month comprised in the period commencing from the day immediately following the expiry of the period specified in the original notice of demand till the taxes are paid in full.

Question 30

On whom and when does section 139(4C) cast responsibility to file a return of income. What will be the effect of failure to comply with the provisions of this section?

Answer

Section 139(4C) applies to -

(i) Research Association referred to in section 10(21);

(ii) News agency referred to in section 10(22B);

(iii) Association or institution referred to in section 10(23A) or 10(23B);

(iv) Fund or institution or trust or university or educational institution or any hospital or medical institution referred to in section 10(23C);

(v) Mutual Fund referred to in section 10(23D)

(vi) Securitization Trust referred to in section 10(23DA)

(vii) Venture Capital Company/Venture Capital Fund referred to in section 10(23FB)

(v) Trade union referred to in section 10(24);

(vi) Body or authority or Board or Trust or Commission (by whatever name called) referred to in section 10(46); and

(vii) Infrastructure debt fund referred to in section 10(47).

These entities shall furnish their return of income if their total income without giving effect to the provisions of section 10, exceeds the maximum amount which is not chargeable to tax.

Failure to comply with the provisions of section 139(4C) will attract penalty under section 272A(2)(e) equal to ₹100 for each day during which the default continues.

Question 31

M/s Shiv Traders, a partnership firm sustained business loss of ₹ 2 lacs, inclusive of admissible depreciation of ₹ 1.15 lacs under section 32 for the year ended 31.3.2016. The firm did not file its return for that year. The Assessing Officer issued a notice under section 142(1) on 1st March, 2017, in compliance to which the firm filed its return for the said year declaring the loss of ₹ 2 lacs, and sought carry forward for next year. Is the firm's claim justified?

Answer

M/s. Shiv Traders failed to file its return of loss within the time allowed under section 139(3) and the same was filed by it in response to notice under section 142(1). The provisions of section 80 read with section 139(3) clearly specify that the benefit of carry forward of business loss can only be claimed if the return of income is filed on or before the due date specified under section 139(1). However, the assessee shall be entitled to carry forward the unabsorbed depreciation of ₹ 1.15 lacs as per provisions of section 32(2). The unabsorbed depreciation shall be added to the depreciation allowance of the following previous year and will be deemed to be part of that allowance of that previous year.

Question 32

(a) In an order of assessment for the A.Y. 2015-16, the assessee noticed a mistake for which application under section 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification under section 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Is the contention of the Assessing Officer correct?

(b) The return for A.Y.2015-16 was filed on time as per section 139(1). Later on, the assessee, noticed certain omissions and therefore filed a revised return on 18.4.2017. The Assessing Officer ignoring the revised return so filed framed the order on 27.4.2017. Is the action of Assessing Officer correct?

Answer

(a) It has been held by the Apex Court in the case of *Hind Wire Industries Ltd. v. CIT (1995) 212 ITR 639* that the order once amended can also be rectified subsequently provided the mistake apparent from record is rectifiable under section 154. The Apex Court enlarged the scope of the words used in that section by stating that it does not necessarily mean the original order. It could be any order including the amended or rectified order. The action of the Assessing Officer is therefore, incorrect.

(b) The original return was filed in time and the proceedings were already taken up for assessment under section 143(2). A revised return was filed by the assessee after a period of one year from the end of the relevant assessment year. The action of the Assessing Officer in making the assessment in disregard of the revised return filed on 18.4.2017 is correct because as per the provisions of section 139(5) the assessee can file the revised return only within a period of one year from the end of the relevant assessment year to which the return relates or before completion of the assessment, whichever is earlier.

Question 33

Rectification of an assessment order under section 154 due to subsequent change of law on retrospective basis is valid in law. Comment.

Is it valid to rectify an assessment order under section 154 due to subsequent change of law on retrospective basis? Also, state, whether a Supreme Court judgment would warrant a rectification under section 154 in respect of an order passed earlier by the Assessing Officer?

Answer

Rectification of assessment order under section 154 due to subsequent change of law on retrospective basis

If the assessment order is plainly and obviously inconsistent with the specific and clear provision as amended retrospectively, undisputably there is a mistake apparent from record. In the light of the retrospective amendment, the assessment order had to be revised. *[CIT vs. E.Sefton and Co. (P.) Ltd. (1989) 179 ITR 435)]*

In view of this, the Assessing Officer can, under section 154, rectify the order of assessment in the light of the later amendment of the law with retrospective effect.

Rectification of assessment order under section 154 on account of subsequent judgment of Supreme Court

The Calcutta High Court, in *Geo Miller and Co. vs. DCIT (2003) 262 ITR 237,* held that a subsequent exposition of law by Supreme Court does not render assessment order as made on mistake.

However, the Gujarat High Court, in *CIT v. Subodhchandra S. Patel (2004) 265 ITR 445,* expressed a different view that non-consideration of a judgment of the jurisdictional High Court or the Apex Court would always constitute a mistake apparent from the record, regardless of the judgment being rendered prior to or subsequent to the order proposed to be rectified.

Question 34

Briefly discuss the concept of accelerated assessment applicable to Association of persons/body of individuals for the assessment year 2017-18.

Answer

Section 174A provides for accelerated assessments in cases of certain Association of Persons (AOP), Body of Individuals (BOI) & Artificial Juridical Persons. If such AOP, BOI etc. is formed or established for a particular event or purpose and the Assessing Officer, apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year before completion of assessment in the normal course, the Assessing Officer may make an assessment of the income upto the date of dissolution as income of the relevant assessment year even without waiting for the end of the previous year or filing of return by the assessee. This provision is on the same basis as contained in section 174 which deals with accelerated assessment of persons leaving India. The provisions of sub-section (2) to (6) of section 174 shall, so far as may be, apply to any proceedings in the case of any such person (AOP, BOI etc.) as they apply in the case of persons leaving India.

Question 35

Can the Assessing Officer complete the assessment under section 144 of the Income-tax Act, 1961 even though there is no failure on the part of the assessee under section 139(1), 139(4), 139(5), 142(1), 142(2A) or 143(2) of the Act? If so, what are the situations?

Answer

As per section 144, the Assessing Officer is empowered to make an assessment of the total income to the best of his judgment when there are failures on the part of the assessee under sections 139(1), 139(4) and 139(5) or sections 142(1), or 142(2A) or 143(2).

The Assessing Officer can exercise this power legally in other situations contemplated under section 145 and he may make the assessment in the manner provided in section 144. Such power is, however, optional and may be exercised in the following situations:

(1) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee;

(2) Where the method of accounting has not been regularly followed by the assessee;

(3) Where the income has not been computed in accordance with "Income Computation and Disclosure Standards" notified by the Central Government under section 145(2).

Question 36

Discuss the correctness of the following statements in the context of the provisions of Income-tax Act, 1961:

(i) "The Joint Commissioner of Income-tax is empowered to issue direction to the Assessing Officer as he thinks fit for the guidance of the Assessing Officer during the assessment proceedings to complete the assessment in a specific manner."

(ii) "Assessing Officer may direct for the audit of the accounts under section 142(2A) of the Act, during the assessment proceeding on the basis of certain grounds".

Answer

(i) The statement is correct.

As per section 144A, a Joint Commissioner may, on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending.

Having regard to the nature of the case or the amount involved or for any other reason, if he considers it necessary or expedient, he may issue such directions as he thinks fit for the guidance of the Assessing Officer during the assessment proceedings to complete the assessment in a specific manner.

Such directions shall be binding on the Assessing Officer.

However, no directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

A direction as to the lines on which an investigation connected with the assessment should be made shall not be deemed to be a direction prejudicial to the assessee.

(ii) The statement is correct.

Section 142(2A) expressly includes within its scope, the following reasons, on the basis of which the Assessing Officer may direct special audit of accounts of an assessee with the previous approval of the Commissioner or Chief Commissioner –

(1) nature and complexity of accounts,

(2) volume of the accounts,

(3) doubts about the correctness of the accounts,

(4) multiplicity of transactions in the accounts,

(5) specialized nature of business activity of the assessee; and

(6) the interests of the revenue.

Question 37

What do you understand by the expression Protective Assessment? Illustrate your answer with an example.

Answer

Under the Income-tax Act, 1961, clubbing provisions enable the Assessing Officer to tax the income of a person in another person's hands under certain circumstances. However, the same income cannot be taxed in the hands of two persons under the law. When the ownership of the income is in dispute or is a matter of doubt, it is open to the Assessing Officer to assess a particular income in the case of the person who is considered as liable to tax and include the same income in the case of another person also as a protective measure. Such an assessment is known as protective assessment.

For example, Mrs. A files her return of income showing a business income of ₹ 2.7 lacs, and if the Assessing Officer is of the view that the said income belongs to her husband, Mr. A, the Assessing Officer can assess the sum of ₹ 2.7 lacs in the hands of Mr. A and shall proceed to assess the same amount in the hands of Mrs. A also on a protective basis.

Protective assessment is made to ensure that when the issue is finally settled, the assessment of such income is not barred by time limitation. When the issue is finally settled in appeal or otherwise, only one assessment will stand and the other one will be cancelled automatically.

Question 38

Mr. Hari, aged 65 years, is a resident and ordinarily resident in India for the A.Y.2017-18. He owns a house property in Dubai, which he purchased on 30.4.2007, and he also has a bank account in the Bank of Dubai.

(a) Mr. Hari contends that since his total income of ₹ 2,80,000 for the P.Y.2016-17, comprising of income from house property and bank interest, is less than the basic exemption limit, he need not file his return of income for A.Y.2017-18.

(b) Mr. Hari also contends that the notice issued by the Assessing Officer under section 148 in June, 2016 for A.Y.2008-09 is not valid due to the following reasons –

(i) There is no escaped income relating to that year; and

(ii) The time period prescribed in section 149 for issuing notice under section 148 for A.Y.2008-09 has since lapsed.

Discuss the correctness of the above contentions of Mr. Hari.

Answer

(a) The first contention of Mr. Hari is not correct.

Section 139(1) requires every resident other than not ordinarily resident, who at any time during the previous year, holds as a beneficial owner or otherwise, any asset (including financial interest in any entity) located outside India or has signing authority in any account located outside India or is a beneficiary of any asset located outside India, to file a return of income compulsorily whether or not he has income chargeable to tax. Mr. Hari has a house property in Dubai and a bank account in the Bank of Dubai. Therefore, Mr. Hari has to file his return of income mandatorily for the A.Y.2017-18, even though his total income of ₹ 2,80,000, comprising solely of income from house property and bank interest, is less than the basic exemption limit of ₹ 3,00,000 applicable to a senior citizen.

(b) Mr. Hari's second contention is also not correct.

Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person is found to have any asset (including financial interest in any entity) located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or re-computation under section 147.

Further, section 149 prescribes an extended time limit of sixteen years for issue of notice under section 148, in case income in relation to such assets located outside India has escaped assessment.

In this case, since Mr. Hari has a house property located outside India in the P.Y.2007-08, income is deemed to have escaped assessment for A.Y.2008-09. Notice under section 148 issued to Mr. Hari in June 2017 in respect of A.Y.2008-09 is valid, since the extended time limit of sixteen years from the end of the relevant assessment year has not expired.

Question 39

Discuss the correctness of the proposition that 'assessment reopened under section 147 cannot be dropped'.

Answer

The proposition is not correct. Under section 152(2), where the assessment is reopened under section 147, an assessee may if he has not impugned any part of the original assessment order for that year either under sections 246 to 248 or under section 264, claim that the proceedings be dropped for the following reasons –

(a) He had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account; or

(b) His assessment or computation had been properly made.

It may be noted that in a reassessment proceeding, the assessee is not eligible to reopen matters concluded by an order under sections 154/155/260/262/263.

Question 40

The assessment of Shah Ltd for the assessment year 2015-16 was completed under section 143(3) on 30.6.2017. There was an audit objection that interest on borrowings ought to have been disallowed partly as there was diversion of borrowed funds to sister concerns without charge of interest. Shah Ltd did not accept the audit objection. On these facts-

(a) What are the options open to revenue to deal with audit objection?

(b) Can the assessment be re-opened?

Answer

(a) One of the options available to Revenue to disallow a part of the interest is by invoking section 263. The Supreme Court in the case of *CIT v. Sree Manjunatheswara Packing Products and Camphor Works 231 ITR 53* has held that the power of the Commissioner under section 263 is of wide amplitude. Section 263 empowers Commissioner to make or cause to be made such inquiry as he deems fit in order to find out whether any order passed by the Assessing Officer is erroneous in so far as is prejudicial to the interests of Revenue. Once he comes to the conclusion on the basis of material that the order of the Assessing Officer is prejudicial to the interests of Revenue, he is empowered to pass an order to enhance, modify, cancel or set aside the assessment and direct a fresh assessment. On the facts of the present case, the Commissioner can call for the records of the case and decide whether there is any error in not disallowing a part of the interest under section 36(1)(iii). If he is satisfied that such an error has been committed, he can issue a notice to the assessee and pass appropriate orders.

(b) The assessment cannot be reopened under section 147 on the basis of an audit objection. Audit party cannot express an opinion on the admissibility of an item of expenditure, since this a matter to be decided by the Assessing Officer having regard to the facts of the case. The amended provisions of section 147 empower the Assessing Officer, to reopen an assessment; if he has "reason to believe" that income has escaped assessment. The Delhi High Court has examined the scope of this power and had held that the belief must be own, not based on change of opinion on the same facts [*Garden Silk Mills Pvt. Ltd v. DCIT (1999) 237 ITR 668].*

Question 41

Examine whether the following actions initiated / taken by the Income-tax Authorities are proper and valid under the provisions of the Act.

(i) The Assessing Officer, within his jurisdiction, surveyed the residential house of an assessee who is engaged in money lending business therefrom on 08.7.2016 (Friday) at 4.30 p.m.

(ii) The assessment completed under section 143(3) for Assessment Year 2010-11 was found to have been based on wrong information given by the assessee. Accordingly, the income of ₹ 1,32,500 earned on 03.05.2009 had escaped assessment, for which, notice under section 148 to reopen the assessment was issued on 11.3.2017.

Answer

(i) The Assessing Officer, under section 133A, is empowered to conduct a survey on the business premises of an assessee within his jurisdiction only during the hours at which such place is open for the conduct of business. In the present case, the assessee was engaged in money lending business from his residence which shall be construed as business premises and therefore, the action of the Assessing Officer to conduct survey on residential premises on Friday, being a working day, at 4.30 p.m., which falls within the working hours, is correct.

(ii) The assessment under section 143(3) was completed for the assessment year 2010-11 and the notice under section 148 was issued on 11.03.2017. The validity of the notice is discussed hereunder.

An assessment completed under section 143(3) can be reopened under section 148 (where the income escaping assessment is more than ₹ 1 lac) within a period of 6 years from the end of the assessment year in which the income was first assessable. The income of ₹ 1,32,500 which escaped assessment could be subjected to reassessment within a period of 6 years from the end of the assessment year to which it relates. The time limit of 6 years from the end of the relevant assessment year (i.e. A.Y. 2010-11) would expire on 31.03.2017. Since the notice was served on 11.03.2017, it is valid in law. After serving notice under section 148, the time limit for completion of assessment would be 9 months from the end of the financial year in which the notice was served. Therefore, the time limit for completion of assessment, in this case, would be upto 31.12.2017.

Question 42

"Nargis", a resident of India, owned for the financial year ended on 31-03-2017, a house property in London purchased in July, 2006; a shop in Sydney purchased in June, 2008 and space in a commercial complex in New York purchased in April, 2014. She is also having authority to operate the bank account (maintained with Citibank, London) of a company owned by her daughter and son-in-law since July, 2015.

She has been served in July, 2017 with the notices issued under section 148 of the Act for assessment years 2005-06 to 2016-17. She, for the reason of challenging the action of the Assessing Officer for issuing notices under section 148 for last 12 years, seeks your opinion. Advise her suitably.

Answer

Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person, being a resident other than not ordinarily resident in India, holds, as a beneficial owner or otherwise any asset located outside India or is a beneficiary of any asset located outside India or has a signing authority in any account located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or recomputation under section 147.

Under section 149, an extended time limit of sixteen years is available for issue of notice under section 148 for an assessment or reassessment, in case income in relation to such assets located outside India has escaped assessment.

As per *Explanation* to section 149, the above provisions, so amended by the Finance Act, 2012, would also apply to any assessment year prior to A.Y.2013-14.

In this case, income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, since Nargis has assets located outside India.

Therefore, on this basis, the Assessing Officer formed a belief that the income has escaped assessment and consequently, issued notice under section 148 for 12 assessment years i.e. from A.Y.2005-06 to A.Y.2016-17.

Hence, the Assessing Officer is justified in invoking reassessment provisions in respect of the earlier assessment years also. However, the extended time limit of 16 years for invoking reassessment proceedings would be available only in respect of A.Y.2007-08 and thereafter, since Nargis first purchased an asset outside India only in July 2006.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Nargis under section 148 for ten assessment years i.e., from A.Y. 2007-08 to A.Y. 2016-17 is in order. However, he cannot issue notice under section 148 for A.Y. 2005-06 and A.Y.2006-07, since the time limit of 4 years or 6 years, as the case may be, has since elapsed.

Question 43

The Assessing Officer accepted the returned income filed by RL Ltd. for a particular assessment year. However, the Assessing Officer initiated reassessment proceeding under section 147 as he had reason to believe that the income had escaped assessment due to claim and allowance of club fees, gifts and presents and provision for leave encashment and accordingly, he issued notice under section 148. However, after sufficient enquiries made by him, he came to the conclusion that no additions were required on account of these expenses. But instead he made additions on account of disallowances under section 14A and section 40(a)(ia) in respect of other expenses which were not the original "reason to believe" and passed his reassessment order under section 147. The Assessing Officer is of the opinion that Explanation 3 to section 147 permits him to assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceeding under section 147, even though the said issues were not part of the reasons recorded in the notice under section 148. Is the action of the Assessing Officer valid ?

Answer

The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, when the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

There are two views in this regard.

First view

[Based on Delhi High Court ruling in Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136]

As per section 147, the Assessing Officer may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under that section. The High Court, in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136 (Delhi)*, observed that the words "and also" used in section 147 are of wide amplitude.

The language of the section is indicative of the position that the assessment or reassessment must be of the income, in respect of which the Assessing Officer has formed a 'reason to believe' for the issue of notice under section 148 **and also** in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment. The correct interpretation, therefore, would be to regard the words **'and also'** as being "conjunctive and cumulative with" and not "in alternative to" the first part of the sentence, namely, "the Assessing Officer may assess and reassess such income".

If the income, the escapement of which was the basis of the formation of the "reason to believe", is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

Applying the rationale of the Delhi High Court ruling, the action of the Assessing Officer in passing a reassessment order under section 147 by making additions on account of disallowances under section 14A and section 40(a)(ia) in respect of other expenses, when the original "reasons to believe" ceased to exist, is not valid.

Second View

[Based on Punjab & Haryana High Court ruling in CIT v. Mehak Finvest P Ltd (2014) 367 ITR 769]

The issue under consideration is whether an addition can be made in reassessment when the original reasons on the basis of which notice for reassessment was issued did not survive.

On this issue, the Punjab & Haryana High Court noted that *Explanation 3 to section 147* nowhere postulates or contemplates that the Assessing Officer cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated. It cited the dismissal of special leave petition (SLP) against the High Court ruling in *Majinder Singh Kang's* case by the Supreme Court on 19.08.2011 as the binding precedent.

The High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, the Assessing Officer is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment

Applying the rationale of the Punjab & Haryana High Court ruling, the action of the Assessing Officer in passing a reassessment order under section 147 by making additions on account of disallowances under section 14A and section 40(a)(ia) in respect of other expenses, when the original "reasons to believe" ceased to exist, is valid.

Question 44

An assessment completed by the Assessing Officer was set aside by the ITAT on 30-01-2016 with a specific direction to re-examine certain disallowances. Before the fresh assessment is made, the Assessing Officer discovers that some other income has escaped assessment. How should he proceed to make fresh assessment?

Answer

If an assessment is set aside and a direction is given to make a fresh assessment, then, the Assessing Officer shall make the fresh assessment under the same section in which the original assessment is made (i.e., under section 143(3)/144/147). For making such assessment, no fresh notice needs to be issued.

However, where an assessment is set aside by the Appellate Tribunal and remanded to the Assessing Officer, it is not open to him to introduce into the assessment new sources of income so as to enhance the assessment.

Any power to modify is confined to the specific disallowances which were the subject-matter of appeal to the Appellate Tribunal. This view is supported by the Punjab & Haryana High Court ruling in the case of *Kartar Singh vs. CIT (1978) 111 ITR 0184.*

In the given case, the assessment has been set aside with a specific direction to re-examine certain disallowances. Hence, in this case, the Assessing Officer has to proceed to make the fresh assessment on the basis of the direction of the Appellate Tribunal, without considering any new source of income which has escaped assessment, within the time limit prescribed under section 153(2A).

However, after completing the fresh assessment as per the direction of the Appellate authority, the Assessing Officer can proceed under section 147 to assess or reassess income chargeable to tax which has escaped assessment by issuing notice under section 148.

Question 45

Discuss, with reasons, whether the following statements are correct:

Mahesh, a resident and ordinarily resident in India and having a house property and a bank account outside India, is not required to file return of income for Assessment Year 2017-18, if his total income is below the maximum amount not liable to tax.

Answer

The statement is incorrect.

As per section 139(1), every person, being a resident other than not ordinarily resident in India who holds, as a beneficial owner or otherwise, any asset located outside India or is a beneficiary of any asset located outside India or has a signing authority in any account located outside India is required to file a return of income in the prescribed form compulsorily, whether or not he has income chargeable to tax.

Therefore, Mahesh has to file a return of income in the prescribed form compulsorily for A.Y.2017-18, even if his total income is below the maximum amount not liable to tax, since he is a resident and ordinarily resident in India and has a house property and a bank account outside India.

Question 46

Mr. A's premises were searched under section 132. During the course of search, certain records pertaining to Mr. B were found. Mr. A and Mr. B wish to know from you the consequences. Advise them.

Answer

As per the provisions of section 132(4A), where any books of account or other documents, etc. are found in the possession or control of the person who is subject to search, then, it shall be presumed that such books of account or documents, etc., belong to such person. Hence, in the present case the records belonging to Mr. B found in the search of Mr. A's premises, shall be deemed to be of Mr. A.

In such a case, the Assessing Officer can seize such records. However, such records seized shall not be retained by the Assessing Officer for a period exceeding 30 days from the date of order of assessment under section 153A. The Assessing Officer may retain the same for a period exceeding 30 days provided he records the reasons for retaining the same in writing and obtains the approval of Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or Principal Director General or Director General or Principal Director or Director for such retention.

However, as per section 153C, where the Assessing Officer is satisfied that any books of account or other documents, etc, seized pertain belong to a person other than the person subject to search under section 132, then the books of account or documents, etc., seized shall be handed over to the Assessing Officer having jurisdiction over such other person. Thereafter, the Assessing Officer having jurisdiction shall proceed against such other person and issue such other person notice and assess or reassess his income as per the provisions of section 153A, only if he is satisfied that the books of account or documents or assets seized or requisitioned have a bearing on the determination of total income of such other person for the relevant assessment year or years referred to in section 153A(1).

Therefore, in the present case, if the Assessing Officer of Mr. A is satisfied that the records pertaining to Mr. B found in the course of search have no bearing on the assessment of Mr. A, he shall hand over the same to the Assessing Officer having jurisdiction over Mr. B. Such Assessing Officer shall proceed with the assessment of Mr. B under section 153A, if he is satisfied that the books of account or documents or assets seized or requisitioned have a bearing on the determination of total income of Mr. B for the relevant assessment year or years referred to in section 153A(1).

Where undisclosed income is found as a result of search, penal provisions under section 271AAB, would be attracted.

Question 47

State with reasons the validity of the following statement:

"Before completing the assessment of any foreign company, the Assessing Officer has to forward a draft of the proposed order of assessment to the assessee".

Answer

The statement is valid.

As per section 144C, the Assessing Officer, in the first instance, has to forward a draft of the proposed order of assessment to the eligible assessee (a foreign company, in this case) if he proposes to make any variation in the income or loss returned which is prejudicial to the interest of such assessee, so as to enable the foreign company to file its objections, if any, to such variation with the Dispute Resolution Panel and the Assessing Officer.

Even if such variation does not arise as a consequence of the order of the Transfer Pricing Officer, such draft assessment order has to be served on the foreign company.

Question 48

M/s. XYZ was subjected to search and seizure. During the course of search, sales, purchase ledgers and property documents pertaining to Mr. A was found in the premises of M/s. XYZ. What is the procedure to be adopted by the Assessing Officer of M/s. XYZ who has seized the records?

Answer

As per section 153C(1), where the Assessing Officer is satisfied that any books of account or documents seized or requisitioned pertains to or the information contained therein relates to any person other than the person subjected to search under section 132 or whose books or documents were seized or requisitioned under section 132A, then, the books of accounts or documents seized or requisitioned **shall be handed over to the Assessing Officer** having jurisdiction over such other person;

That Assessing Officer having jurisdiction over such other person shall issue notice and assess or reassess income of such other person in accordance with the provisions of section 153A subsequent to such transfer of books and records seized or requisitioned, **only if he is satisfied that the books of account or documents seized or requisitioned have a bearing on the determination of total income of such other person for the relevant assessment year** or assessment years referred to in section 153A(1).

In this case, if Mr. A is subject to the jurisdiction of the same Assessing Officer as that of M/s. XYZ, the said Assessing Officer shall proceed against Mr. A, otherwise, the Assessing Officer of M/s. XYZ should hand over the sales, purchase ledgers and property documents pertaining to Mr. A to the Assessing Officer having jurisdiction over Mr. A, if he is satisfied that the same pertains to Mr. A or any information contained therein relates to Mr. A.

Thus, the same Assessing Officer or the Assessing Officer having jurisdiction over Mr. A, as the case may be, shall proceed against Mr. A and issue notice and assess or reassess the income of Mr. A in accordance with the provisions of section 153A, only if he is satisfied that the books of account and documents have a bearing on the determination of total income of Mr. A for the relevant assessment year or assessment years referred to in section 153A(1).

Question 49

Mr. Shyam had e-filed his income-tax return for A.Y.2016-17 within the due date declaring a total income of ₹ 9,50,000. Such total income, inter alia, includes dividend from Indian companies of ₹ 50,000 and long term capital gains on sale of shares of ₹ 2,00,000. However, Mr. Shyam correctly disclosed both such incomes in the schedule of exempt income. Consequently, the said return got processed under section 143(1) denying both the above exemptions and intimation was served on Mr. Shyam raising a demand of tax. After receipt of *said intimation, assessee filed a revised return but time limit of filing revised return under section 139(5) had lapsed and such revised return was held invalid. Assessee filed for rectification under section 154 which was also rejected by Assessing Officer.*

Decide the correctness of action of the Assessing Officer.

Answer

The facts of the case are similar to the facts in *Sanchit Software and Solutions Pvt. Ltd. v. CIT (2012) 349 ITR 404*, wherein the Bombay High Court observed that the entire object of administration of tax is to secure the revenue for the development of the country and not to charge the assessee more tax than which is due and payable by the assessee.

An error was initially committed by the assessee while e-filing his return. Incomes which were exempt ought not to have been shown as part of his total income. However, the assessee had shown the impugned amounts as exempt, in the schedule of exempt income. While processing such return under section 143(1)(a), the system could not have detected this error and hence was processed, accepting the income returned by the assessee. The Assessing Officer, however, cannot take advantage of a mistake committed by the assessee.[1]

In the case on hand, since there is an error on the face of the intimation under section 143(1), the rectification filed under section 154, obviously within the stipulated time limit, cannot be rejected by the Assessing Officer.

Hence, the action of the Assessing Officer is **not correct.**

Exercise

1. *Filing of return of income on or before due date is necessary for carry forward of all losses - Discuss the correctness of this statement.*
2. *Who are the persons authorised to sign the return of income in the case of -*
   a) *Hindu Undivided Family*
   b) *Company*
   c) *Partnership firm*
3. *List ten transactions for which quoting of permanent account number is mandatory.*
4. *Write short notes on -*
   a) *Regular assessment*
   b) *Best judgment assessment*
5. *Write short notes on -*

[1] CBDT Circular dated 11th April, 1955

   a) *Valuation of inventory for tax purposes*

   b) *Tax Return Preparers*

6. *Does the Assessing Officer have power to make a reference to the Valuation Officer? If so, under what circumstances can he exercise such power?*

7. (i) *Discuss the procedure for assessment in search cases under section 153A of the Income-tax Act, 1961?*

   (ii) *What is the time limit for completion of such search assessments?*

8. *Anirudh filed return of income for A.Y. 2016-17 claiming a refund of ₹ 37,500. The said refund was granted and paid to the assessee on 1st March, 2017 after processing the return under section 143(1). Later on, the case was taken up for regular assessment by issue of notice under section 143(2) and the said assessment was completed on 7th September, 2017 resulting in demand of ₹ 6,300. Is the assessee liable to pay interest on the amount of refund already granted to him and if so, what is the amount of such interest?*

9. *Rallis Ltd. filed its original return for the previous year 2014-15 on 28th September, 2015 declaring loss of ₹ 16.25 lakhs. Thereafter, it filed a revised return on 28th February, 2017 declaring loss of ₹ 19.3 lakhs. The assessment of Rallis Ltd. was not completed at that point of time. The Assessing Officer opined that the loss indicated in the original return alone can be carried forward for set-off in the subsequent yeas, since section 80 does not contemplate that a revised return can be filed. Is the contention of the Assessing Officer correct? Discuss.*

10. *Can intimation under section 143(1)(a) be issued after notice for regular assessment is issued under section 143(2)?*

Answers

8. As per section 234D, where any refund is granted to the assessee after processing the return under section 143(1) and later on, in the regular assessment there is no refund due or the amount refunded exceeds the amount refundable, the assessee shall be liable to pay simple interest at ½% for every month or part of a month from the date of grant of refund to the date of such regular assessment on the whole or the excess amount so refunded.

The assessee was granted refund on 1.3.2017 after processing the return under section 143(1). The regular assessment under section 143(3) was completed on 7.9.2017 and resulted in tax payable of ₹ 6,300. Therefore, no refund was due on regular assessment. Accordingly, the assessee is liable to pay interest under section 234D on ₹ 37,500 at ½% for 7 months (i.e. from 1st March, 2017 to 7th September 2017; part of a month is to be considered as full month).

Interest payable by the assessee under section 234D works out to ₹1,313 (i.e. ₹ 37,500 × ½% × 7 months).

9. Rallis Ltd. had filed its original return under section 139(3) before the time allowed under section 139(1) i.e. before 30th September, 2015. It has also filed its revised return within the time allowed under section 139(5) i.e. before the expiry of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier. In this case, the assessment was yet to be completed and one year from the end of the relevant assessment year expires on 31.3.2017. Since Rallis Ltd. has filed its revised return on 28.2.2017, it was within the time allowed under section 139(5).

A perusal of section 139(3) makes it clear that a return of loss filed under section 139(3) may be filed within the time allowed under section 139(1). Once such a return is filed, all the provisions of the Act shall apply as if such return has been filed under section 139(1). In other words, a return filed under section 139(3) is deemed to be a return filed under section 139(1). The provision contained in section 139(3) makes it clear that all the provisions of the Act shall apply to such a return as if it were a return under section 139(1). In view of such a specific provision, there is no further necessity in section 80 to refer to such provision. Hence, there is no reason to exclude the applicability of section 139(5) to a return filed under section 139(3). Therefore, a loss return filed under section 139(3) can be revised by filing a revised return under section 139(5) within the time allowed. Such loss as per the revised return can be carried forward, even though section 80 does not specifically provide for carry-forward of loss which has been determined in pursuance of return filed under section 139(5).

This principle has been supported by the Madras High Court in *CIT v. Periyar District Co-op. Milk Producers Union Ltd. (2004) 266 ITR 0705/ 137 Taxman 364 (Mad.)*

The contention of the Assessing Officer is, therefore, incorrect.

10. As per the provisions of section 143(1D), notwithstanding anything contained in section 143(1), the processing of a return under section 143(1) shall not be necessary before the expiry of one year from the end of the financial year in which the return is made, where a notice of assessment has been issued to the assessee under section 143(2) for scrutiny of the return within six months from the end of the financial year in which the return is furnished.

However, such return has to be processed before issuing an order under section 143(3).

22

Settlement of Tax Cases

Question 1

X & Co Ltd. had made an application to the Settlement Commission. The issue in the said application related to cash credits in the books of account. The Commission passed an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax. Discuss the validity of the order of the Settlement Commission.

Answer

The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax.

Section 245D(4) provides that the Settlement Commission, after examination of records and the report of the Commissioner and after examining such further evidence as may be placed before it or obtained by it, may, in accordance with the provisions of the Act, pass such order as it thinks fit.

Further, section 245D(5) provides that the materials brought on record before the Settlement Commission shall be **considered** by the Members of the concerned Bench before passing any order under section 245D(4).

"Consideration" means independent examination of the evidence and material brought on record before the Settlement Commission by the members and application of mind thereto with a view to independently assess the materials and evidence, whether adduced by the applicant or by the Commissioner, and come to a conclusion by themselves.

This view has been upheld in case of *Supreme Agro Foods P Ltd. v. Income-tax Settlement Commission (2013) 353 ITR 385 (P&H)*

The Settlement Commission, therefore, has to consider the material brought on record before it and "consideration" means independent examination of the evidence and material on record.

In this case, since the material was available before the Settlement Commission and such material has been taken into consideration for returning a finding which is relevant for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified.

Therefore, the order of the Settlement Commission is valid.

Question 2

On an application made by Mr. Pandey, an order was passed by the Settlement Commission on 03-01-2017 under Section 245D(6B). The said order had a mistake apparent on record. The Settlement Commission suo-moto passed an amended order dated 30-07-2017 which resulted in modifying the liability of Mr. Pandey.

Mr. Pandey is of the view that order of the Settlement Commission is final and conclusive and it has no power to rectify the said mistake.

You are required to examine the following:

(i) Correctness of claim made by Mr. Pandey

(ii) Validity of the order amended by the Settlement Commission

Answer

(i) Under section 245F(1), the Settlement Commission has been conferred all the powers which are vested in an income-tax authority under the Act. Under section 154, an income-tax authority has the power to amend any order passed by it in order to rectify any mistake apparent from the record. Therefore, the Settlement Commission's power to amend an order to rectify any mistake apparent from the record is embedded in section 245F(1).

Further, in order to reflect the correct intention of the legislature, section 245D(6B) specifically provides that the Settlement Commission may, at any time within a period of six months from the end of the month in which the order was passed, amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. In this case, the rectification order was passed by the Settlement Commission within six months from the end of the month in which the order was passed (i.e. by 31.7.2017)

Therefore, Mr. Pandey's view is not correct.

(ii) In this case, the rectification has the effect of modifying the liability of Mr. Pandey. Therefore, as per the second proviso to section 245D(6B), the Settlement Commission, before passing the amended order, should have –

(1) given a notice to the applicant and the Principal Commissioner/Commissioner of its intention to make such an amendment; and

(2) allowed the applicant and the Principal Commissioner/Commissioner an opportunity of being heard.

If these conditions are fulfilled, the order amended by the Settlement Commission would be a valid order, since the amended order is passed by the Settlement Commission within the permitted time limit i.e., within six months from the end of the month in which the original order was passed.

However, if the Settlement Commission has not given notice of its intention to make such an amendment or has not allowed the applicant and the Principal Commissioner/ Commissioner an opportunity of being heard, then, the amended order passed by it will not be valid.

Question 3

Seizures were made from Mr. Sunder pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Sunder and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Sunder, however, contended that the order of the Settlement Commission was final and any fresh analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Sunder's contention.

Answer

The Apex Court, in *CIT vs. Om Prakash Mittal (2005) 273 ITR 326*, observed that a plain reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for:-

(i) the terms of settlement; and

(ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The decision that the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the action be initiated by the Settlement Commission, *suo moto*. The Revenue can move the Settlement Commission for decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud or misrepresentation of facts, it cannot be said that there is a full and true disclosure and therefore, the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench’s decision.

Mr. Sunder's contention is, therefore, not correct.

Question 4

Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C of the Income-tax Act? Discuss.

Answer

The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in *CIT v. Anjum M.H.Ghaswala reported in (2001) 252 ITR 1.*

According to the judgment, sub-section (6) of section 245D is only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections. However, as per provisions of section 245F, the Settlement Commission shall have all the powers which are vested in an income-tax authority. Therefore, Settlement Commission can grant relief from the aforesaid interest to the extent of the powers given vide the circulars issued by CBDT under section 119.

Question 5

(a) Does the Settlement Commission have jurisdiction to entertain an application made under section 245C(1) in respect of a case covered by Chapter XIV-B (Search and seizure case).

(b) Discuss the power of the Settlement commission to grant immunity from prosecution and penalty.

Answer

(a) Section 245A(b) defines the term `case' to mean any proceeding for assessment under the Act of any person in respect of any assessment year or years which is pending before the Assessing Officer on the date on which an application is made to the Settlement Commission.

Search cases are eligible for settlement through the Settlement Commission. *Explanation* to section 245A(b), provides that in case of a person referred to in section 153A or section 153C, a proceeding for assessment or reassessment shall be deemed to have been commenced on the date of issue of notice initiating such proceeding for assessment under section 153A or section 153C and concluded on the date on which the assessment is made. During this period, application for settlement of the case could be filed by the assessees.

Further, section 245C provides that an application before the settlement commission in cases falling under section 153A and 153C can be made, where the additional amount of income-tax payable on income disclosed in the application exceeds ₹ 50 lakh, in respect of the tax payer who is the subject matter of search and ₹ 10 lakh, in respect of entities related to such a tax payer, who are also the subject matter of search.

Moreover, such tax and interest thereon, which would have been payable had such income been disclosed in the return of income before the Assessing Officer on the date of application, should be paid on or before the date of making the application. Further, proof of such payment should be attached with the application.

(b) The power of Settlement Commission to grant immunity from prosecution and penalty is provided for in section 245H.

In respect of an application made on or after 1st June, 2007, the Settlement Commission's power to grant immunity from prosecution is restricted to offences under the Income-tax Act, 1961 and Wealth-tax Act, 1957. The Settlement Commission can also grant immunity from penalty imposed under the Income-tax Act, 1961. Such immunity from prosecution and penalty may be granted subject to conditions as it may think fit to impose.

However, the Settlement Commission may grant immunity only if the person who has made the application has co-operated with the Settlement Commission and made a full and true disclosure of his income and the manner in which it was derived. Further, the Settlement Commission while granting immunity to any person from prosecution shall record the reasons in writing in the order passed by it.

Also, the Settlement Commission cannot grant immunity if the prosecution proceeding for any such offence has been instituted before the date of receipt of application for settlement under section 245C.

Question 6

The business premises of Mr. Amit was subjected to a survey under section 133A of the Act. There were some incriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Amit by approaching the Settlement Commission.

Answer

An assessee may, at any stage of a **case** relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Amit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹ 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Amit has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Amit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961 / Wealth-tax Act, 1957, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Amit, if he approaches the Settlement Commission.

Note: *Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.*

Question 7

Explain the powers of Settlement Commission to amend its order.

Answer

As per the section 245D(6B), the Settlement Commission may amend any order passed by it under section 245D(4) to rectify a mistake apparent from the record, within six months from the date of the order.

However, an amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission –

(1) has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so; and

(2) has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

Question 8

M/s. A Ltd. has received a notice under section 148 for the Assessment Year 2013-14 on 02-02-2017. They also anticipate similar notices for the Assessment Years 2011-12 and 2012-13 for which they have already furnished return of income. On examination of the books of account produced, you have noticed huge amounts of concealed income. As a consultant, what is your advice to A Ltd.?

Answer

As per section 245C, an assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission.

"Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made.

A proceeding for assessment or reassessment or recomputation under section 147 is deemed to have commenced from the date of issue of notice under section 148. Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y.2013-14 and also anticipates similar notices for the A.Y.2011-12 and A.Y.2012-13, for which return of income has been furnished. Thus, a proceeding for assessment is pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.

Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹ 10 lakhs has also been satisfied.

Based on these facts, assuming that the necessary conditions are fulfilled, our advice as consultant to M/s A Ltd. would be to approach the Settlement Commission to have his case settled and apply for grant of immunity from penalty and prosecution.

Exercise

1. *Define the term "Case" for the purpose of settlement of cases.*
2. *Discuss the jurisdiction and powers of the Settlement Commission.*
3. *What is the binding nature of the orders of the Settlement Commission?*

23

Advance Rulings

Question 1

State the powers of the Authority for Advance Ruling under the Income-tax Act, 1961.

Answer

Under section 245U, the Authority of Advance Ruling will have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the Authority of Advance Ruling shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Question 2

Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2016-17 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2017-18 as well. Mr. Balram's brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Ruling on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2017-18. Can he do so?

Answer

As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Ruling shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2017-18.

Note *– Though the ruling of the Authority for Advance Rulings is not binding on others but there is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings de hors the binding nature [CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.)].*

Question 3

Explain as to what the term 'Advance Ruling' means under the Income-tax Act 1961.

Answer

The term 'Advance Ruling' has been defined in section 245N(a) to mean :-

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a **non-resident applicant**; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken **by a resident applicant with such non-resident**; or

(c) a determination by the Authority in relation to the tax liability of a **resident applicant**, arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**,

and such determination shall include the determination of any question of law or of fact specified in the application

(c) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

Question 4

Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2016 in relation to a transaction proposed to be undertaken by him. On 31.8.2016, he decides to withdraw the said application. Can he withdraw the application on 31.8.2016?

Answer

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR), in *M.K.Jain AAR No.644 of 2004*, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period with the permission of the AAR, if the circumstances of the case so justify.

Question 5

A foreign company entered into contracts with several Indian companies for installation of mobile telephone system and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Indian companies. One of the Indian companies had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of the foreign company justified in law?

Answer

The matter relates to the admission or rejection of the application filed before the Advance Ruling Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

Clause (i) of the first proviso of section 245R(2) provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court. (except in case of resident falling in sub-clause (iii) of clause (b) of section 245N)

In the above case, no application had been filed or contention urged by the applicant (foreign company) before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. One of the Indian companies, however, had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non-resident. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held by the AAR in *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203,* the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by the non-resident. Hence, it would not be proper to reject the application of the foreign company relying on clause (i) of the proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

Question 6

Can a person resident in India seek advance ruling from the Authority for Advance Ruling?

Answer

A resident can made an application to the Authority of Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(iia) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(iii) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

"Public sector companies" as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

Question 7

When can an advance ruling pronounced by the Authority for Advance Rulings be declared void? What is the consequence?

Answer

As per section 245T, an advance ruling can be declared to be *void ab initio* by the Authority for Advance Ruling if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

Question 8

Macline Cola Co. of UK entered into contracts with three Indian companies namely ABC Ltd., Pepsi Co. Ltd. and Coca Cola Ltd. for supplying know-how. Macline Cola Co. made an application to the Authority for Advance Rulings (AAR) on the rate of withholding tax on receipts applicable to it.

Also, Coco Cola Ltd. also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the payment made to non-resident company i.e., Macline Cola Co.

The Authority for Advance Rulings (AAR) rejected the application of Macline Cola Co. on the ground that the question raised in the application is already pending before an Income-tax authority.

Explain whether the rejection of application by the AAR is justified in justified in law?

Answer

The matter relates to the admission or rejection of the application filed before the Authority for Advance Rulings on the ground specified in clause (i) of the first proviso to section 245R(2). The said clause provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.

In this case, no application had been filed or contention urged by the applicant foreign company, namely Macline Cola Co., before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. However, one of the Indian companies, namely, Coca Cola Ltd., had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to the foreign company. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held in *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203 (AAR),* the application filed by the Indian company, Coca Cola Ltd., before the Assessing Officer cannot be treated to have been filed by the foreign company, Macline Cola Co.

Hence, the rejection of the application of Macline Cola Co. by the AAR on the ground that the question raised in the application is already pending before an income-tax authority is not justified.

Exercise

1. *Define the following terms under the Income-tax Act, 1961 -*

   (a) Advance Ruling; and (b) Applicant

2. *What is the eligibility for being appointed as members of the Authority for Advance Rulings?*
3. *What is the procedure to be followed by the Authority for Advance Rulings on receipt of an application under section 245Q?*
4. *What are the restrictions on the applicability of an advance ruling pronounced by the Authority?*

24

Appeals and Revision

Question 1

"SVS Propcon" did not make a claim of ₹ 20 lacs in the return of income filed for A.Y. 2016-17 which was disallowed in the previous assessment year under section 43B. However, the said claim was also not considered by the Assessing Officer during assessment proceedings on the ground that no revised return was filed. Can the assessee now make such claim before the appellate authority?

Answer

Yes, the assessee is entitled to raise additional claims before the appellate authorities.

The restriction that an additional claim has to be made by filing a revised return applies only in respect of a claims made before the Assessing Officer. An assessee cannot make a claim before the Assessing Officer otherwise than by filing a revised return. It was so held by the Supreme Court in *Goetze (India) Ltd v. CIT (2006) 284 ITR 323.*

However, this restriction does not apply to an additional claim made before an appellate authority. The appellate authorities have jurisdiction to permit additional claims before them, though, the exercise of such jurisdiction is entirely the authorities' discretion. It was so held by the Bombay High Court in *CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336.*

Thus, an additional claim can be raised before the Appellate Authority even if no revised return is filed.

Question 2

Discuss the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:

(i) An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.

(ii) A High Court does not have an inherent power to review an earlier order passed by it on merits.

Answer

(i) The statement given is not correct. As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.

(ii) **The statement given is *not* correct.** The Supreme Court, in *CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112*, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India. There is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

Question 3

Does the Income-tax Appellate Tribunal have the following powers?

(i) *Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals);*

(ii) *Power to recall its own order.*

Answer

(i) The Income-tax Appellate Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). It has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. The decision of the Supreme Court in the case of *National Thermal Power Company Limited vs. CIT (1998) 229 ITR 383 (SC)* supports this view.

(ii) The Delhi High Court, in *Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB)* observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in *Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466,* dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. The Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Question 4

Can a rectification order under section 254 of the Income-tax Act, 1961 be passed by the Income-tax Appellate Tribunal beyond 6 months from the end of the month in which the order sought to be rectified was passed?

Answer

The issue as to whether a rectification order can be passed by the Income-tax Appellate Tribunal under section 254 beyond six months from the end of the month in which order sought to be rectified was passed, has been addressed in *Sree Ayyanar Spinning and Weaving Mills Ltd. v. CIT (2008) 301 ITR 434 (SC)*. Section 254(2), dealing with the power of the Appellate Tribunal to pass an order of rectification of mistakes, is in two parts. The first part refers to the *suo motu* exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal.

If Income-tax Appellate Tribunal, *suo moto,* makes the rectification of its order, then the order has to be passed within 6 months from the end of the month in which the order sought to be rectified was passed. Where the application for rectification is made by the Assessing Officer or the assesse within 6 months from the end of the month in which the order sought to be rectified was passed, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation i.e. order can be passed after expiry of 6 months from the end of the month in which the order sought to be rectified was passed. However, the application for rectification cannot be filed belatedly after 6 months from the end of the month in which the order sought to be rectified was passed. [*Ajith Kumar Pitaliya vs ITO (2008) 167 Taxmann 24 (M.P.)]*

Question 5

What do you mean by substantial question of law?

Answer

The expression "substantial question of law" has not been defined anywhere in the Act. However, it has acquired a definite meaning through various judicial pronouncements. The tests are:

(1) whether directly or indirectly it affects substantial rights of the parties; or

(2) the question is of general public importance; or

(3) whether it is an open question in the sense that issue is not settled by the pronouncement of the Supreme Court or Privy Council or by the Federal Court; or

(4) the issue is not free from difficulty; or

(5) it calls for a discussion for alternative view.

Question 6

Examine the correctness of the following statement:

The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in appeals before it.

Answer

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed.

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay.

Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Therefore, the statement given in the question is not correct.

Question 7

Is Commissioner (Appeals) empowered to consider an appeal filed by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates?

Answer

Section 251(1) lists the powers of the Commissioner (Appeals) in disposing of an appeal. Clause (aa) of section 251(1) empowers the Commissioner (Appeals), in an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, to confirm, reduce, enhance or annul the assessment after taking into consideration the following -

(1) all the material and other information produced by the assessee before the Settlement Commission;

(2) the results of the inquiry held by the Settlement Commission;

(3) the evidence recorded by the Settlement Commission in the course of the proceeding before it; and

(4) such other material as may be brought on his record.

Question 8

An Income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income-tax department on a particular issue in case of one assessee, Alpi for assessment year 2015-16 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2016-17, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y. 2016-17 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki?

Answer

Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y. 2016-17 both for Alpi and Palki.

Question 9

A petition for stay of demand was filed before ITAT by XYZ Ltd. in respect of a disputed demand for which appeal was pending before it, on which stay was granted by the ITAT vide order dated 1.1.2016. The bench could not function thereafter till 1.2.2017 and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on 16.2.2017 and recovered the amount of ₹ 15 lacs against the arrear demand of ₹ 25 lacs. The assessee requested the Assessing Officer to refund back the amount as it holds stay over it. The Assessing Officer rejected the contention of the assessee. Now the assessee seeks your opinion.

Answer

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay. Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. Section 254(2A) provides that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

In the present case, the period of 365 days has expired on 31.12.2016, after which date the order of stay stands vacated. Accordingly, the recovery of ₹ 15 lacs against the arrear demand of ₹ 25 lacs made by the Assessing Officer is in order.

Question 10

An assessee who had been served with an order of assessment passed under section 143(3) on 1.1.2017 had filed an application against this order before the CIT as per section 264 on 11.1.2017. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion.

Answer

An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) passed on 1.1.2017, had moved an application for revision of order under section 264 on 11.1.2017. The order passed by the Assessing Officer under section 143(3) is an order appealable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e., upto 31.1.2017. This time limit had not expired on 11.1.2017 and the assessee had also not waived his right of appeal while filing the application for revision on 11.1.2017 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2017 and the assessee had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2017 under section 264. Therefore, the Commissioner's refusal to entertain such application is correct.

Note : *In real life situations, the Commissioner could have kept the proceedings in abeyance till the expiry of the time prescribed for filing appeal by the assessee and thereafter could have assumed jurisdiction for making revision besides taking an undertaking from the assessee for waiving his right of appeal. In reality, taxpayers usually will not prefer revision in such short time period nor would the Commissioner reject the application, the moment it is received by him.*

Question 11

(a) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. State with reasoning whether the action of the Commissioner is justified as to the second notice.

(b) State the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.

Answer

(a) The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of *Explanation* to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the *Explanation* to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner, Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasised in *Explanation (b)* to section 263(1).

(b) As per Rule 46A(1) of the Income-tax Rules 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer; or

(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal; or

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

Question 12

Discuss the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:

(a) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.

(b) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.

(c) The High Court cannot interfere with the factual finding recorded by the lower authorities and the Tribunal, without any valid reasons.

Answer

(a) The proposition is correct in law. The Supreme Court has, in *CIT vs. McMilan & Co. (1958) 33 ITR 182 and CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225*, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do, what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate reliefs.

The Allahabad High Court has, in *CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318*, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

Further, the Apex Court has, in the case of *Jute Corporation of India Ltd. vs. CIT (1991)* 187 *ITR* 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter.

Thus, the powers of the Commissioner of Income-tax (Appeals) in enhancing the assessment are very wide and plenary.

(b) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either *suo-moto* or on an application made by the assessee or Assessing Officer, with a view to rectifying any mistake apparent from record, at any time within 6 months from the end of the month of the order sought to be amended.

The powers of the Tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification *[CIT vs. Vardhman Spinning (1997) 226 ITR 296 (P & H), CIT v. Ballabh Prasad Agarwalla (1998) 233 ITR 354 (Cal.) & Niranjan & Co. Ltd. v. ITAT (1980) 122 ITR 519 (Cal.)]*

(c) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is the final fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In *CIT vs. P. Mohanakala (2007) 291 ITR 278 and M. Janardhana Rao v. Joint CIT (2005) 273 ITR 50*, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are *per se* without reason or basis, perverse and/or contrary to the material on record.

Hence, only if the issue gives rise to a substantial question of law, an appeal shall lie before the High Court.

Question 13

Answer the following in the context of provisions contained in the Income-tax Act, 1961:

The assessment for A.Y. 2014-15 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2015. Subsequently, this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalisation Fund". The order of reassessment was passed on 24.11.2016. The Commissioner within the powers vested under section 263 passed an order on 11.4.2018 rejecting the claim of assessee as to "Lease Equalisation Fund". The assessee challenges that the action of the CIT is not sustainable because the same was barred by limitation.

Answer

This issue was settled by the Supreme Court in *CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1.* The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings.

Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 23.12.2015 and the revision should have been made by 31.3.2018.

***Note** – The difference between partial merger and total merger has been explained for the understanding of the students. The doctrine of partial merger would apply in the case of section 263.*

The third proviso in section 147, inserted by Finance Act, 2008, provides that the doctrine of partial merger shall apply to reopening in a case where an assessee has filed an appeal etc.

for an assessment year. It has been provided that the Assessing Officer may assess or reassess such income, other than income which has been the subject matter of any appeal or reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger also holds good for section 154.

However, the concept of total merger would apply in the case of section 264. The Commissioner of Income-tax has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal and irrespective of the fact whether the appeal is by the assessee or by the Department as the concept of total/complete merger is applicable for section 264.

Question 14

An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each under the Income-tax Act, 1961:

(i) passed under section 143(3) by the Assessing Officer.

(ii) passed under section 263 by the Commissioner of Income-tax.

(iii) passed under section 272A by the Director General.

(iv) passed under section 254 by the ITAT.

Answer

(i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Principal Commissioner or Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within

120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 15

Write a brief note on filing of memorandum of cross-objections before the Income-tax Appellate Tribunal.

Answer

Section 253(4) of the Income-tax Act, 1961 gives the respondent, in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any part of the order of the Commissioner (Appeals) or of the Deputy Commissioner (Appeals) or of the Assessing Officer in pursuance of direction of Dispute Resolution Panel. This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2) of section 253(2A). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3) or section 253(3A). There is no fee for filing a memorandum of cross-objections.

Question 16

An appeal was preferred by the assessee to the Commissioner (Appeals) against the order of assessment made by the Assessing Officer. The appeal was allowed by the Commissioner (Appeals). The assessee later found that he was entitled to a certain deduction, which was neither claimed by him nor allowed by the Assessing Officer in the course of assessment. The issue of deduction was not raised by the assessee in the appeal before the Commissioner (Appeals) and was not considered by the Commissioner (Appeals). Examine the power of the Commissioner to revise under section 264 the order of assessment in order to allow such deduction on an application by the assessee.

Answer

Section 264(4)(c) provides that the Principal Commissioner or Commissioner shall not revise an order which has been made the subject of an appeal to the Commissioner (Appeals). This bar remains unaffected by the scope of the appeal to the Commissioner (Appeals). Therefore, the fact that the relief claimed in the application filed by the assessee under section 264(1) was not the subject matter of appeal to the Commissioner (Appeals) does not alter the position that the order of assessment was the subject of the appeal.

The Supreme Court has, in *Hindustan Aeronautics Ltd. v. CIT (2000) 243 ITR 808*, held that the Principal Commissioner or Commissioner has no power to revise any order under section

264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal.

The word 'order' in section 264(4)(c) refers to the order appealed against and not to the relief claimed in appeal. In view of this, the Principal Commissioner or Commissioner cannot exercise his powers under section 264 to revise the order of assessment and allow the deduction claimed by the assessee in his application.

Question 17

S, an individual, filed his return of income for the assessment year 2016-17 erroneously offering for taxation, interest received from notified Relief Bonds exempt under section 10(15), in the said return. The Assessing Officer completed the assessment under section 143(3) on 20.4.2017 accepting the income returned by S. S had furnished complete particulars relating to the interest income in the return of income. S approaches you for advice regarding the steps to be taken to secure exemption of the income. Advice S about the various remedies available under the Income-tax Act, 1961 for the redressal of his grievance.

Answer

S can file an appeal under section 246A, against the order of assessment, to the Commissioner (Appeals). The law is well settled that an appeal can be filed by an assessee even against inclusion in assessment, of such income erroneously included by him in the return of income. Reliance is placed on the decision of the Delhi High Court in *CIT v. Bharat General Reinsurance Co. Ltd. (1971) 81 ITR 303.*

If an assessee makes a mistake in submitting a return of income and submits to be assessed on a particular income before the assessing authority, he is not estopped or precluded by law from preferring an appeal and showing to the appellate authority that the income is, in fact, either wholly or partly, not exigible to tax. If such a contention is taken, it is the duty of the appellate authority to examine the matter and determine the proper tax leviable. There is no question of invoking the doctrine of estoppel in such a case *[Narsepalli Oil Mills v. State of Mysore (1973) 32 STC 599 (Mys.)]*

In the alternative, S can file a revision petition under section 264 with the Principal Commissioner or Commissioner of Income-tax seeking exemption of interest from Relief Bonds, not claimed in the return of income and not allowed in the order of assessment.

The other course of action S could take is to file an application under section 154 with the Assessing Officer, seeking rectification of the order of assessment made. The consistent judicial view is that exemption not claimed by the assessee and not allowed by the Assessing Officer, though the material relating thereto was in the return of income, constitutes a mistake apparent from the record within the meaning of section 154.

Question 18

The assessment of Ashok for assessment year 2015-16 was completed under section 143(3) on 15th January, 2017. The Commissioner acting under section 263 directed the Assessing Officer to add a certain amount appearing in the Balance Sheet in the total income of Ashok.

Ashok did not challenge the order of the Commissioner under section 263 by filing appeal to the Tribunal. The Assessing Officer passed a fresh assessment order on 1st October, 2017 including the said amount in the total income of Ashok pursuant to the order of the Commissioner.

Ashok disputed the fresh assessment order in appeal to Commissioner (Appeals) under Section 246A. The Commissioner (Appeals) dismissed the appeal on the ground that the Assessing Officer only complied with direction of the Commissioner under section 263, which was not disputed by Ashok in appeal to Tribunal. Examine the correctness of the stand taken by the Commissioner (Appeals).

Answer

An assessee can file an appeal to the Tribunal against the order passed by the Principal Commissioner or Commissioner under section 263. However, in this case, the assessee did not file any appeal to the Tribunal against the order of the Commissioner under section 263. He waited for the fresh assessment order to be passed by the Assessing Officer in pursuance of the direction of the Commissioner. The order of any fresh assessment made under section 150 pursuant to a direction contained in an order of revision under section 263 is itself appealable under section 246A(1)(b). Therefore, the mere fact that the assessee did not dispute the order of the Commissioner by filing an appeal to the Tribunal does not take away the right of the assessee to dispute the fresh assessment order by filing appeal to Commissioner (Appeals) under section 246A. Therefore, the stand taken by the Commissioner (Appeals) is not correct in law.

Question 19

Discuss the following propositions:

(i) The Income Tax Appellate Tribunal cannot admit additional evidence during the hearing of the appeal.

(ii) The Commissioner of Income-tax can revise an order during the pendency of an appeal before the First Appellate Authority.

(iii) The Commissioner of Appeals cannot admit an appeal filed beyond 30 days from the date of receipt of order by an Assessee.

Answer

(i) Rule 29 of Appellate Tribunal Rules, 1963 deals with production of additional evidence before the Appellate Tribunal.

The parties to the appeal shall not be entitled to produce additional evidence, either oral or documentary, before the Tribunal. However, the following are the exceptions to this rule –

(a) where the Tribunal requires any document to be produced or any witness to be examined or any affidavit to be filed to enable it to pass orders or for any other substantial cause; or

(b) where the income-tax authorities have decided the case without giving sufficient opportunity to the assessee to adduce evidence either on points specified by them or not specified by the them.

In case (a) above, the Tribunal may allow such document to be produced or witness to be examined or affidavit to be filed.

In case (b) above, the Tribunal may allow such evidence to be adduced.

However, in both cases, the Tribunal should record its reasons in writing.

(ii) Revision of orders by the Commissioner can be carried out under section 263 or section 264.

Revision of orders prejudicial to the interest of revenue [Section 263]

Section 263(1)(c) provides that if an order passed by the Assessing Officer has been the subject matter of any appeal, the same cannot be revised. However, at the same time, the power of the Principal Commissioner or Commissioner under sub-section (1) of section 263 shall extend to such matters as had not been considered and decided in such appeal.

Revision of other orders [Section 264]

The Principal Commissioner or Commissioner shall not revise any order under section 264, where an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal, but it has not been made and the time within which such appeal may be made has not expired. However, if the assessee has waived his right of appeal, the Principal Commissioner or Commissioner can revise the order under this section.

(iii) As per section 249(3) of the Income-tax Act, 1961, the Commissioner (Appeals) may admit an appeal after the expiry of the period of 30 days specified in section 249(2) if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the prescribed time.

Question 20

An assessee is aggrieved by the order of the Assessing Officer and requests you to contest the same by filing an appeal before the Commissioner of Income-tax (Appeals) as well as by filing a revision petition before the Commissioner under section 264 of the Act. Can the assessee invoke simultaneously both the remedies against the order of the Assessing Officer.

Answer

Section 264(4) provides that the Principal Commissioner or Commissioner shall not revise any order under section 264 in the following cases –

(a) Where any appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal but has not been made and the time within which such appeal may be made has not expired or, in the case of an appeal to the Commissioner (Appeals) or the Appellate Tribunal, the assessee has not waived his right of appeal; or

(b) Where the order has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal.

Even though the provisions of section 246A do not specifically bar an appeal being filed simultaneously along with a revision petition under section 264, it is clear from a reading of section 264 that the assessee is barred from seeking revision unless he has waived the right of appeal.

Therefore, it is clear that the assessee can either apply for revision before the Principal Commissioner or Commissioner under section 264 or file an appeal before the Commissioner of Income-tax (Appeals), but cannot invoke both the remedies simultaneously.

Question 21

In the assessment of a firm, the Assessing Officer made two additions (i) Unexplained cash credits ₹ 1 lac. (ii) Disallowance under section 43B. The firm filed an appeal before the CIT and being unsuccessful before the Appellate Tribunal only on the addition of unexplained cash credits. It was not successful in either forum. With regard to the disallowance under section 43B, it did not file any appeal, but preferred a revision petition before the CIT under section 264, who dismissed it on the ground that the assessment was the subject matter of an appeal to the Appellate Tribunal. The assessee relies on the Board's circular under which the CIT is empowered to accept such a petition. Is the petition maintainable?

Answer

The Supreme Court in *Hindustan Aeronatics Ltd v. CIT (2000) 243 ITR 898* has laid at rest any controversy on this point. It has held that under section 264, the Commissioner has no power to revise any order which has been made the subject matter of an appeal to the Appellate Tribunal, even if the relief claimed in the petition is different from the relief claimed in appeal. With regard to the Board's circular, the instructions are, no doubt, binding on the authorities under the Act but where the Supreme Court or High Court has declared the law on the question arising for consideration, it will not be open to a court to direct that a circular would be given effect to, over-riding the order of the High Court or Supreme Court.

Hence, the petition is not maintainable.

Question 22

Discuss the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961.

(i) Commissioner (Appeals) has no power to decide a matter that was not raised before him.

(ii) The Income-tax Appellate Tribunal cannot amend its orders.

(iii) A case before the Appellate Tribunal cannot be dealt when there is a difference of opinion amongst the members of the Bench.

(iv) An appeal shall lie to the High court against the order of the Tribunal.

Answer

(i) This proposition is not correct. Under the *Explanation* to section 251(2) the Commissioner (Appeals) in disposing of an appeal, may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, even if such matter was not raised before him by the appellant. The power of admission of any grounds of appeal is conferred on the CIT (Appeals) under section 250(5), if he is satisfied that the omission in the grounds of appeal was not wilful or unreasonable.

(ii) The proposition is not correct. Under section 254(2), the Tribunal may, within 6 months from the end of the month in which the order was passed, rectify any mistake apparent from record if it is brought to its notice either by the Assessing Officer or by the assessee. However, an amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made unless a notice has been given to the assessee of the intention to do so and a reasonable opportunity of being heard has been given. The Tribunal, however, has no inherent power to re-appreciate the correctness of its own decision on merits.

(iii) This proposition has been negatively stated and is not correct. Under section 255(4), if the members of a Bench of the Tribunal differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority. If the members are equally divided, they shall state the point or points on which they differ and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more members of the Tribunal. Such point shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who first heard it.

(iv) Under section 260A(1), an appeal shall lie to the High Court from every order passed by the Appellate Tribunal, if the High Court is satisfied that the case involves a substantial question of law.

To be “substantial”, a question of law must be debatable, not previously settled by law of the land or a binding precedent and must have a material bearing on the decision of the case, if answered either way, in so far as the rights of the parties before it are concerned.

Question 23

If an assessee fails to make a claim for any deduction in the return of income, he loses his opportunity for claiming such deduction at the assessment stage or subsequent stage. Do you agree with the proposition?

Answer

(i) As per section 80A(5), where the assessee fails to make a claim in his return of income for any deduction under section 10AA or under any provision of Chapter VIA under the heading "C - Deductions in respect of certain incomes", no deduction shall be allowed to him thereunder at a later stage. However, it can be claimed through a revised return provided the time limit for filing the revised return as mentioned in section 139(5) has not expired.

(ii) However, the restriction under section 80A(5) is not applicable for other deductions under Chapter VIA or to deductions under any particular head of income.

It may be noted that the Supreme Court in the case of *Goetze India Ltd. v. CIT 284 ITR 323* has held that a fresh claim for deduction can be made before the Assessing Officer only by filing a revised return of income.

The Supreme Court has, however, made it clear that the adjudication was only with reference to the power of the Assessing Officer to entertain a fresh claim for deduction otherwise than through a return of income and does not impinge on the power of the Tribunal under section 254.

Therefore, if an assessee fails to claim a deduction under Chapter VIA other than deductions mentioned in section 80A(5), it

(1) can be claimed by him by making an application for rectification of a mistake apparent from record under section 154 before an Income-tax Authority or under section 254 before the Appellate Tribunal. The availability of the impugned deduction should be apparent from the details furnished in the return of income or in the statements/details filed in case of assessment under section 143(3).

(2) can be claimed before Commissioner (Appeals) by raising the additional ground, if the Commissioner (Appeals) is satisfied that such a ground could not have been raised at the time of filing of return or at the time of making of the assessment order and such ground became available because of change in law or change in circumstances.

(3) can be allowed by the Income-tax Appellate Tribunal even if such an issue was not raised before lower authorities. This can be done *suo moto* or an application made by the assessee.

(4) can be claimed under section 264 before the Principal Commissioner or Commissioner of Income-tax, if the same has not been allowed by the Assessing Officer.

Therefore, the proposition that **any deduction** not claimed in the return of income, cannot be claimed at the assessment stage or subsequent stage is not true.

Question 24

Assessment of Bhajan Ltd. was completed under section 143(3) with an addition of ₹ 15 lakhs to the returned income. The assessee-company preferred appeal before the Commissioner (Appeals) which is pending now.

In this backdrop, answer the following:

(i) *Based on fresh information that there was escapement of income for the same assessment year, can the Assessing Officer initiate reassessment proceedings when the appeal is pending before Commissioner (Appeals)?*

(ii) *Can the Assessing Officer pass an order under section 154 for rectification of mistake in respect of issues not being subject matter of appeal?*

(iii) *Can the assessee-company seek revision under section 264 in respect of matters other than those preferred in appeal?*

(iv) *Can the Commissioner make a revision under section 263 both in respect of matters covered in appeal and other matters?*

Answer

(i) As per the third proviso to section 147, the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger would apply in this case.

Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can initiate reassessment proceedings in respect of income chargeable to tax which has escaped assessment, provided such income is not the subject matter of the appeal before the Commissioner (Appeals) i.e., such income which has escaped assessment does not form part of the additions of ₹15 lakhs to the returned income, which is the subject matter of appeal.

(ii) As per section 154(1A), the Assessing Officer can pass an order under 154(1) to rectify a mistake apparent from the record, provided the rectification is in relation to a matter, other than the matter which has been considered and decided in the appeal before Commissioner (Appeals). The doctrine of partial merger holds good for section 154 also.

Since the issue under consideration in this case relates to rectification of a mistake in respect of a matter which is not the subject matter of appeal, the Assessing Officer can pass an order under section 154 for rectification of the same provided the same is a mistake apparent from the record.

(iii) As per section 264(4), the Commissioner shall not revise any order under section 264, where such order has been made the subject of an appeal to the Commissioner (Appeals). Thus, the concept of total merger would apply in the case of section 264.

Therefore, under section 264, the Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal.

(iv) As per section 263, the Commissioner has the power to revise an order prejudicial to revenue, even if the order is the subject matter of appeal before Commissioner (Appeals). However, the power of the Commissioner under section 263 shall extend to only such matters as had not been considered and decided in such appeal. Here again, the doctrine of partial merger would apply.

In a case where the appeal is pending but not yet decided, the Commissioner cannot exercise his revisionary jurisdiction in respect of those issues which are the subject matter of appeal [*CWT v. Sampathmal Chordia (2002) 256 ITR 440 (Mad.)].*

Question 25

The assessment of South West Bank Limited for Assessment Year 2012-13 was made under section 143(3) on 30th November, 2013 allowing deduction under section 36(1)(viia) on account of provision for doubtful debts and deduction in respect of foreign exchange rate difference as claimed in the return of income. Subsequently, the Assessing Officer initiated reassessment proceeding under section 147 in respect of deduction under section 36(1)(viii) for special reserve created by the bank. The order under section 147 was passed on 31st December, 2015. Later, the Principal Commissioner after examining the record of assessment initiated revisionary proceeding under section 263 by issue of show cause notice to the bank and passed an order under section 263 on 31st August, 2016 for disallowing in part deduction under section 36(1)(viia) and deduction for foreign exchange rate difference. The bank claims that the order passed by the Principal Commissioner under section 263 is barred by limitation.

Examine the correctness or otherwise of the claim of the bank.

Answer

Section 263(2) provides that no revisionary order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed.

The issue under consideration is whether the period of limitation for an order passed under section 263 has to be reckoned from the original order passed by the Assessing Officer under section 143(3) of the Income-tax Act, 1961 or from the order of reassessment passed under section 147, where the subject matter of revision is different from the subject matter of reassessment under section 147.

The facts of the case are similar to the facts in *CIT v. ICICI Bank Ltd. (2012) 343 ITR 74*, wherein the above issue came up before the Bombay High Court. Similar issue also came up recently before the Bombay High Court *in CIT v. Lark Chemicals Ltd (2014) 368 ITR 655*. The Bombay High Court relied on the Apex Court decision in the case of *CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1*, wherein it was held that in such cases where the subject matter of revision was not the same as the subject matter of reassessment, the period of limitation would commence from the date of original assessment and not from the date of reassessment.

In this case, the period of limitation as referred to in section 263 is with reference to the assessment in which the claim of the assessee as to deduction under section 36(1)(viia) on account of provision for doubtful debts and deduction in respect of foreign exchange rate difference was considered. These issues were not the subject matter of reassessment proceedings, which were only in respect of deduction under section 36(1)(viii) for special reserve created by the bank.

Accordingly, applying the rationale of the Bombay High Court rulings cited above, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment.

Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 30.11.2013 and the revision should have been made by 31.3.2016. However, the revision order was passed only on 31st August, 2016 and hence, the same is barred by limitation.

Accordingly, the claim of the bank that the order passed by the Principal Commissioner under section 263 is barred by limitation is correct.

Question 26

Can Commissioner (Appeals) refuse to admit an appeal even though such appeal is filed within time?

Answer

As per section 249(4), the Commissioner (Appeals) can refuse to admit an appeal, even though such appeal is filed within the stipulated time, where at the time of filing of the appeal:

(a) In a case where a return of income has been filed by the assessee, the assessee has not paid the tax due on the income returned by him; or

(b) In a case where no return of income has been filed by the assessee, the assessee has not paid an amount equal to the amount of advance tax which was payable by him.

However, in case (b), the assessee/appellant can apply to the Commissioner (Appeals) for exemption from the requirement of prepayment of advance tax. The Commissioner (Appeals) may, for any good and sufficient reason to be recorded in writing, exempt him from the said requirement.

Exercise

1. *Explain briefly the four stages of appeal under the Income-tax Act, 1961.*
2. *List ten orders appealable before the Commissioner (Appeals).*
3. *What are the powers which can be exercised by the Commissioner (Appeals) while disposing of an appeal?*
4. *Write short notes on the following -*
    (a) *Constitution of Appellate Tribunal*
    (b) *Time limit for disposing appeals.*

5. *Which are the orders against which an aggrieved assessee can file an appeal to the Appellate Tribunal?*
6. *Write short notes on -*
   - *(a) Appeal to the Supreme Court*
   - *(b) Provision for avoiding repetitive appeals*
7. *Discuss the Commissioner's powers to revise an order prejudicial to the interests of Revenue.*
8. *Explain the Commissioner's powers under section 264 to revise other orders.*
9. *The assessee, Mr. Ram, declared the cost of construction of cinema theatre at ₹ 10.53 lakh, based on the registered valuer's report. The Assessing Officer accepted the value of the theatre as declared by the assessee and completed the assessment. However, the Commissioner, on enquiry, found that the assessee had availed a loan of ₹ 17 lakh from a leasing company declaring the value of the theatre at ₹ 27.40 lakh. Therefore, the Commissioner, after giving the assessee an opportunity of being heard, set aside the order of assessment and directed the Assessing Officer to make fresh assessment after verification and enquiry. On appeal before the Tribunal, the assessee questioned the order of the Commissioner by contending that the invocation of the provision under section 263 is not sustainable in law, since there was no information relating to any proceedings under the Income-tax Act, 1961 available before the Assessing Officer which show that the assessment was erroneous and prejudicial to the Revenue. Discuss the correctness of the assessee's contention.*

Answers

9. This issue was resolved by the Madras High Court in *CIT v. Dr. K. Ramachandran (2004) 139 Taxman 320.* The High Court observed that the *Explanation* to section 263 provides that the term "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of the examination by the Commissioner. In *CIT v. Shree Manjunathesware Packing Products & Camphor Works (1998) 231 ITR 53(SC),* the Apex Court made it clear that section 263 enables the Commissioner to call for and examine the records of any proceedings under the Act and pass such orders thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment or canceling the assessment and directing a fresh assessment, if he considers that the order passed by the Assessing Officer is erroneous and prejudicial to the interest of the Revenue. For this purpose, record would include not only record which was available to the Assessing Officer at the time of passing the assessment order, but would include the records available with the Commissioner at the time of passing of the order by the Commissioner.

The High Court also relied on its earlier decision in the case of *CIT v. M.N. Sulaiman (1999) 238 ITR 139*, wherein it followed the above decision of the Supreme Court. The High Court further held that the *Explanation* added to section 263(1) in the year 1988 has to be regarded as declaratory.

Therefore, since the term "record" includes all records available at the time of passing of order under section 263 by the Commissioner and is not restricted to information available to the Assessing Officer at the time of passing the assessment order, the assessee's contention is not correct.

25

Penalties

Question 1

"Discuss the provisions for levy of penalty on undisclosed income arising consequent to a search initiated on 30.4.2016.

Answer

In order to deter the practice of non-disclosure of income, section 271AAB provides for levy of penalty on undisclosed income found during the course of a search, which relates to specified previous year, i.e.-

- the previous year which has ended before the date of search, but the due date of filing return of income for the same has not expired before the date of search and the return has not yet been furnished (P.Y. 2015-16);
- the previous year in which search is conducted (P.Y. 2016-17).

Accordingly, under section 271AAB,

- penalty @ 10% would be attracted, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be) and furnishes the return of income for the specified previous year declaring such undisclosed income.
- penalty@20%, if undisclosed income relating to the specified previous year is **not admitted during the course of search** in the statement furnished under section 132(4) **but the same is disclosed in the return of income** filed after the date of search and the tax along with the interest, if any, is paid before the specified date
- In all other cases, penalty @60% of undisclosed income would be attracted.

Note: *If the search is initiated on or after the date on which the Taxation Laws (Second Amendment) Bill, 2016 receives the assent of the President, penalty@30% would be attracted in a case where undisclosed income is admitted during the course of search in a statement furnished under section 132(4). In any other case, penalty@60% of undisclosed income* *would be attracted. The Taxation Laws (Second Amendment) Bill, 2016 has been passed by the Lok Sabha on 29.11.2016.*

Question 2

What is the quantum of penalty that could be levied in each of the following cases -

(i) Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.

(ii) Failure to comply with a direction issued under section 142(2A).

(iii) Failure to furnish report from an accountant as required under section 92E.

Answer

The penalty that could be levied in each case is:-

(i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961 - a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of ₹ 1,50,000, whichever is less [Section 271B].

(ii) Failure to comply with a direction issued under section 142(2A) – a sum of ₹ 10,000 [Section 272A(1)(d)].

(iii) Failure to furnish report from an accountant as required by section 92E - a sum of ₹ 1,00,000 [Section 271BA].

Question 3

X, an individual whose total sales in the business of food grains for the year ending 31.3.2017 was ₹ 205 lacs, did not maintain books of account. The Assessing Officer levied penalty of ₹ 25,000 under section 271A for non-maintenance of books of account and penalty of ₹ 1,02,500 under section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?

Answer

X is required to maintain books of account as per section 44AA and get them audited under section 44AB, since his gross sales exceeded ₹ 1 crore. He is liable to pay penalty under section 271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty of ₹ 25,000 under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In *Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691*, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 4

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its *Circular No 784 dated 22-11-1999* has clarified that "genuine hardship" referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Commissioner and at the time of passing of order under section 273A(4) by the Commissioner.

(ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

As per the decision of Andhra Pradesh High Court in *K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269,* if the above two conditions are satisfied, the Commissioner has no discretion to refuse to exercise his powers. In case the quantum of penalty exceeds ₹ 1 lakh, the Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

Note - *The Principal Commissioner or Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.*

Question 5

An assessee had credited a sum of ₹ 50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of ₹ 50,000 as the income *of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of ₹ 60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.*

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be ₹ 50,000. Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing officer happens to be a Joint Commissioner the levy of penalty will be invalid. Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self contradictory. The moment the amount of ₹ 50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. *[Diwan Enterprises v. CIT and Others (2000) 246 ITR 571].*

Question 6

Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of ₹ 10,000. They have not furnished the requisite information in spite of various reminders.

Answer

(i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

(ii) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of ₹ 100 for every day during which the failure continues.

> ***Note –*** *In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Principal Director/Director or Principal Commissioner/Commissioner as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.*

Question 7

Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?

Answer

Under section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, the Transfer Pricing Officer is a competent authority to levy penalty.

Section 271G confers aforesaid power to the Transfer Pricing Officer for levy of penalty.

Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.

Exercise

1. *What is the penalty leviable under the Income-tax Act, 1961 for -*
    - *(a) failure to keep or maintain or retain books of account as required under section 44A.*
    - *(b) failure to furnish audit report as required under section 92E;*
    - *(c) failure to furnish statement of financial transaction and reportable account within the prescribed time.*
2. *Discuss the provisions under the Income-tax Act, 1961 which authorise the reduction or waiver of penalty by the Commissioner of Income-tax.*
3. *What is the period of limitation for levy of penalty under Chapter XXI?*
4. *Does the Commissioner have power to grant immunity from penalty? Discuss.*

26

Offences and Prosecutions

Question 1

Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.

(i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.

(ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).

(iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C.

Answer

(i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which **prosecution can be launched under section 275B** and such person shall be punishable with rigorous imprisonment **for a term which may extend to two years and shall also be liable to fine.**

(ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which **prosecution can be launched under section 276D** and such person shall be **punishable with rigorous imprisonment for a term which may extend to one year and with fine.**

(iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which **prosecution can be launched under section 276BB** and such person shall be **punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.**

Question 2

The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the A.Y.2014-15 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was ₹ 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was ₹ 1,000. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case.

Answer

Section 276CC provides for prosecution for wilful failure to furnish a return of income within the prescribed time, in a case where tax would have been evaded had the failure not been discovered. Since the amount of tax which would have been evaded does not exceed ₹ 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by the assessee on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed ₹ 3,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded ₹ 3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ₹ 1,000, which is less than ₹ 3,000. Therefore, since the tax liability of the firm on final assessment was determined at ₹ 1,000, the prosecution proceedings are not maintainable.

In *Guru Nanak Enterprises v. ITO (2005) 279 ITR 30*, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

Question 3

Explain section 278C applicable in respect of offences committed by Hindu undivided families.

Answer

As per section 278C(1) of the Income-tax Act, 1961, where an offence under the Income-tax Act, 1961 has been committed by a Hindu undivided family (HUF), the karta shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, the karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under the Income-tax Act, 1961 has been committed by a HUF and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any member of the HUF, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Exercise

1. *Is prosecution attracted in respect of the following offences? If so, what is the period of imprisonment?*

   (a) Removal, concealment, transfer or delivery of property to thwart tax recovery;

   (b) Wilful attempt to evade tax, penalty or interest;

2. *Write short notes on the following -*

   (a) Offences by companies; and (b) Presumption as to culpable mental state.

3. *Enlist the offences which are deemed to be non-cognizable offences.*

4. *Discuss the power of the Commissioner to grant immunity from prosecution.*

5. *Can the Department launch prosecution in a case where they have accepted the revised return filed by the assessee, rectifying a mistake in the original return of income?*

Answer

5. This question came up before the Karnataka High Court in *K.E. Sunil Babu, Asst. CIT v. Steel Processors (2006) 286 ITR 315*. The High Court observed that since the Department had accepted the revised returns filed under section 139(5), it was clear that there was a bona fide mistake in the original return and there was no element of *mens rea.* Therefore, the High Court held that the Department cannot launch prosecution under sections 276C, 277 and 278.

27

Miscellaneous Provisions

Question 1

How does the income of a person who is trying to alienate his assets with a view to avoid tax be dealt with under the Act?

Answer

The income of a person who is trying to alienate his assets with a view to avoid tax will be dealt with as per the provisions of section 175.

Accordingly, if it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under the Income-tax Act, 1961, the total income of such person for the period from the expiry of the previous year to the date when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

The total income of each completed year or part of any previous year included in such period shall be chargeable to tax at the rates in force in that assessment year and separate assessments will be made for each completed previous year or part of any previous year.

The Assessing Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

The tax chargeable under this section shall be in addition to tax, if any, chargeable under any other provision of the Act.

Question 2

Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time alongwith interest, under different schemes run by it. Following transactions were noted from their books of account:

(i) *Mr. A, an individual, has deposited ₹ 15,000 on 1st May, 2013 for 48 months by bearer cheque and another ₹ 15,000 on 30th June, 2016 in cash to purchase a new certificate of 48 months tenure.*

(ii) *Mr. A has applied for premature withdrawal against both the certificates and the company has paid him ₹ 16,500, by a bearer cheque, against principal and interest on 23rd March,*

2017, due against his first certificate (purchased in 2013) and ₹ 15,500 in cash on 25th March, 2017, against the second certificate.

Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held by Mr. A with his wife Mrs. A, jointly, while repaying back in cash or bearer cheque?

Answer

(i) There is no violation of section 269SS at the time of acceptance of the first deposit of ₹ 15,000 by bearer cheque on 1.5.2013, since it is not in excess of the threshold limit of ₹ 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2016, since as on that date, there is already an outstanding deposit of ₹ 15,000 and another cash deposit of ₹ 15,000 would take the aggregate to ₹ 30,000, which exceeds the threshold limit of ₹ 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

(ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2017, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than ₹ 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of ₹ 15,500 on 25th March, 2017 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of ₹ 20,000.

The provisions of section 269T will be attracted at the time of first repayment of bearer cheque even if the certificate is being held by Mr. A in joint name with his wife.

Question 3

The proceedings before the Income-tax Authorities either can be attended by the assessee in person or through an authorized representative. Who can be treated as an authorized representative of the assessee?

Answer

As per section 288, the proceedings before the income-tax authorities can be attended by an assessee in person or through an authorised representative, i.e., a person authorized by the assessee in writing to appear on his behalf, being -

(i) a person who is a relative or a regular employee of the assessee; or

(ii) any officer of a Scheduled Bank in which the assessee maintains a current account or has other regular dealings; or

(iii) a legal practitioner who is entitled to practise in any civil court in India; or

(iv) a chartered accountant within the meaning of the Chartered Accountants Act, 1949; or who hold a valid certificate of practice

(v) any person who has passed any accountancy examination recognized in this behalf by the CBDT for this purpose; or

(vi) any person who has acquired such educational qualifications as prescribed by the CBDT; or

(vii) any person who, before the coming into force of this Act in the Union territory of Dadra and Nagar Haveli, Goa, Daman and Diu, or Pondicherry, attended any proceedings before an income-tax authority in the said territory on behalf of any assessee otherwise than in the capacity of an employee or relative of that assessee

(viii) any person who was actually practising as an income-tax practitioner, immediately before commencement of the Income-tax Act, 1961.

Question 4

An order for A.Y. 2015-16 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y.2014-15 and the relevant previous year as ending on 31.3.2014. The assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT(Appeals).

Answer

Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. **Therefore, a clerical mistake cannot invalidate an otherwise valid assessment.** Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

Question 5

"Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:

(i) What are the prescribed modes of service of such notice?

(ii) On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.

Answer

(i) As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice to be addressed and served on
A dissolved firm	Any person who was a partner (not being a minor) immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

Question 6

"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such proclamation be made under the Act?

Answer

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district, of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –

(i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and

(ii) at such other places as the Tax Recovery Officer may direct;

(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Immovable Property [Rule 54 of Schedule II to the Income-tax Act, 1961]

The Tax Recovery Officer shall make a proclamation for sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or in both, and the cost of such publication shall be deemed to be cost of the sale.

Where the property to be sold is divided into lots for the purpose of being sold separately, then it is not necessary to make a separate proclamation for each lot of property, unless in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

Question 7

Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also state the period of time for which such attachment can take place.

When can the Assessing Officer revoke provisional assessment of property? Discuss.

Answer

As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e.-

(i) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.

(ii) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

(iii) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.

(iv) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

(v) Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal

Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assesse furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

Question 8

Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B.

Answer

The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of *Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209*.

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Deduction, Collection and Recovery of Tax

Question 1

Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2016 a sum of ₹ 80,000 was deducted at source from the contractors. The statement of tax deducted at source under section 200 was filed on 23rd March, 2017 for the quarter ended 31.12.2016.

(i) Is there any delay on the part of Mr. Madhusudan in filing the statement of TDS?

(ii) If the answer to (i) above is in the affirmative, how much amount can be levied on Mr. Madhusudan for such default under section 234E?

(iii) Is there any remedy available to him for reduction/waiver of the levy?

Answer

(i) Yes, there has been a delay on the part of Mr. Madhusudan in filing the statement of TDS.

As per section 200(3) read with Rule 31A, the statement of tax deducted at source for the quarter ended 31st December, 2016 has to be filed on or before 31st January, 2017. However, the same has been filed only on 23rd March, 2017. Hence, there has been a 51 days delay on the part of Mr. Madhusudan in filing the statement of TDS.

(ii) As per section 234E of the Income-tax Act, 1961, where a person fails to file deliver or cause to be delivered the statement of tax deducted at source within the prescribed time, then, he shall be liable to pay, by way of fee, a sum of ₹ 200 for every day during which the failure continues.

The amount of fee shall not, however, exceed the amount of tax deductible.

In this case, since Mr. Madhusudhan has delayed filing the statement of TDS by 51 days, he would be liable to pay a fee of ₹ 10,200 (₹ 200 x 51 days) under section 234E. The said fee does not exceed the tax deductible (₹ 80,000, in this case).

(iii) The CBDT is empowered to issue general or special orders, whether by way of relaxation of any of the provisions of sections 139, 143, 144, 147 etc. or otherwise, in respect of any class of incomes or class of cases. The CBDT may issue such order(s) from time to time if it considers expedient so to do, for the purpose of proper and efficient management of the work of assessment and collection of revenue. Section 234E is included in the list of sections in respect of which the CBDT is empowered to issue order for relaxation of the provisions of the Act.

Hence, the remedy available to Mr. Madhusudhan is that he can file an application to the CBDT under section 119 and seek waiver/reduction of the penalty levied/leviable under section 234E.

Question 2

Smt. Vijaya, proprietor of Lakshmi Enterprises, made turnover exceeding ₹ 100 lakhs during the previous year 2015-16. Her turnover for the year ended 31-3-2017 was ₹ 90 lakhs.

Decide whether provisions relating to deduction of tax at source are attracted for the following payments made during the financial year 2016-17:

(i) Purchase commission paid to one agent ₹ 25,000 on 13.6.2016 towards purchases made during the year.

(ii) Payments to Civil engineer of ₹ 5,00,000 for construction of residential house for self use.

Answer

Since Smt. Vijaya's turnover exceeded ₹ 100 lakhs in the immediately preceding financial year (i.e., F.Y.2015-16), she is liable to deduct tax at source in the P.Y.2016-17, irrespective of her turnover being less than ₹200 lakhs in the F.Y.2016-17.

(i) Tax@5% has to be deducted under section 194H in respect of purchase commission of ₹ 25,000 to an agent for purchases made during the year, since the same exceeds the threshold limit of ₹ 15,000 for non-deduction of tax at source thereunder.

(ii) Tax has to be deducted under section 194C in case of payment to resident contractors. The rate of tax is 1% if the payee is an individual or HUF and 2% in case of payees, other than individuals and HUFs.

However, as per section 194C(4), no individual or Hindu undivided family shall be liable to deduct income tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of the Hindu undivided family.

In this case, since Smt. Vijaya, an individual, makes payment of ₹ 5 lakh to a civil engineer for construction of residential house for self use, she is not liable to deduct tax at source under section 194C from such sum.

Question 3

Mr. Sharma, an employee of M/s. ABC Ltd. since 10-04-2013 resigned on 31-03-2017 and withdrew ₹ 60,000 being the balance in his EPF account. State with reasons whether the provisions of Chapter XVII-B are attracted and if so, what is the net amount receivable by the payee, Mr. Sharma?

Answer

As per section 192A, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@10% at the time of payment of accumulated balance due to the employee. Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is ₹ 50,000 or more.

Rule 8 of Part A of the Forth Schedule, *inter alia*, provides that only if an employee has rendered continuous service of five years or more with the employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from the total income of that employee.

In the present case, Mr. Sharma has withdrawn an amount exceeding ₹ 50,000 on his resignation after rendering a continuous service of four years with M/s. ABC Ltd. Therefore, tax has to be deducted at source@10% under section 192A on ₹ 60,000, being the amount withdrawn on his resignation without rendering continuous service of a period of five years with M/s. ABC Ltd.

The net amount receivable by Mr. Sharma is ₹ 54,000 [i.e., ₹ 60,000 – ₹ 6,000, being tax deducted at source].

***Note** – It is assumed that Mr. Sharma has furnished his permanent account number (PAN) to the person responsible for deducting tax at source. Otherwise, tax would be deductible at the maximum marginal rate. It may be noted that w.e.f. 01.06.2015 such employee can furnish declaration in Form No.15G for non-deduction of tax at source under section 192A by virtue of section 197A(1A).*

Question 4

'X' while making payment "net of tax" to a non-resident for providing technical services on a world bank aided project had deducted tax out of such payments as per rates prescribed but says that the payee is not entitled for the TDS certificate. Examine.

Answer

As per section 198, any sum deducted in accordance with the provisions of Chapter XVII-B of the Income-tax Act, 1961 is deemed to be income received while computing the income of the payee.

As per section 203, every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.

Even in a case where ‘X undertakes to pay the tax on the grossed up amount, the non-resident shall be entitled for issue of certificate for tax deducted at source in respect of payment made ‘net of tax’ in terms of section 195A. This has been clarified vide CBDT Circular No.785 dated 24.11.1999.

Therefore, X has a legal obligation to issue TDS certificate to the non-resident, even if he has made payment of income "net of tax" to him.

Question 5

State the rate at which the tax either is to be deducted or collected under the provisions of the Act in the following cases:

(i) A partnership firm making sales of the timber which was procured and obtained under a forest lease.

(ii) Payment of income on investments in the securities to the Foreign Institutional Investor.

(iii) A nationalized bank receiving professional services from a registered society made provision on 31-03-2017 of an amount of ₹ 25 lacs against the service charges bills to be received.

(iv) Payment of ₹ 5 lacs made to Mr. Phelps who is an athlete by a manufacturer of a swim wear for brand ambassador.

Answer

Applicable Rate of TDS/TCS

	Situation	TCS/TDS	Rate	Note
(i)	Partnership firm selling timber obtained under forest lease	TCS	2.5%	1
(ii)	Payment of income on investments in the securities to the Foreign Institutional Investors	TDS	20.6%	2
	In case the securities are Government securities		5.15%	
(iii)	Professional services rendered by a registered society to a nationalised bank	TDS	10%	3
(iv)	Payment by a manufacturer of swim wear to its brand ambassador Mr. Phelps, an athlete	TDS		4
	If Mr. Phelps is a resident		10%	
	If Mr. Phelps is a non-resident		20.6%	

Notes:

(1) As per section 206C(1), tax has to be collected at source@2½% by the partnership firm, being a seller, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier.

(2) As per section 196D, tax has to be deducted at source @ 20.6% (20% plus cess@3%) by any person who is responsible for paying to a Foreign Institutional Investor, any income by way of interest on securities at the time of credit of such income to the account of the payee or at the time of payment of such income, whichever is earlier.

Alternatively, if the said securities are assumed to be government securities, tax is deductible@5.15% (i.e., 5% plus cess@3%) under section 194LD.

(3) Tax has to be deducted at source@10% under section 194J, by the nationalized bank at the time of credit of fees for professional services to the account of the registered society (i.e., on 31.3.2017), even though payment is to be made after that date.

(4) Tax has to be deducted at source@10% under section 194J[1] in respect of income of ₹ 5 lacs paid to Mr. Phelps, athlete, for advertisement, on the inherent presumption that Mr. Phelps is a resident.

Alternatively, if Mr. Phelps is assumed to be a non-resident, who is not a citizen of India, tax has to be deducted at source@20.6% (20% plus cess 3%) under section 194E in respect of income of ₹ 5 lacs paid to Mr. Phelps, an athlete, for advertisement referred under section 115BBA.

Question 6

Discuss the liability for tax deduction at source in the following cases for the assessment year 2017-18:

(i) Wings Ltd. has paid amount of ₹ 15 lacs during the year ended 31-3-2017 to Airports Authority of India towards landing and parking charges.

(ii) Omega Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. John from UK to bring artists to India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the company. He did not take part in event organized in India. The company made the payment of commission of ₹ one lac to the overseas agent.

(iii) Ramesh gave a building on sub-lease to Mac Ltd. with effect from 1-7-2016 on a rent of ₹ 15,000 per month. The company also took on hire machinery from Ramesh with effect from 1-11-2016 on hire charges of ₹ 10,000 per month. The rent of building and hire charges of machinery for the year 2016-17 were credited by the company to the account of Ramesh in its books of account on 31-3-2017.

(iv) ₹ 2,45,000 paid to Mr. X on 01-02-2017 by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agriculture land?

Answer

(i) TDS on landing and parking charges: The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical

[1] CBDT Circular No.715 dated 8.8.1995

communication facilities, installation and maintenance of navigational aids and meteorological services at the airport. *[Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)].*

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of ₹ 15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2016-17.

(ii) TDS on services of overseas agent outside India: An overseas agent of an Indian company operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for contacting and negotiating with artists by Mr. John, a non-resident, who remains outside India is not subject to tax in India, consequently, there is no liability for deduction of tax at source. It is assumed that the commission of ₹ 1 lakh was remitted to Mr. John outside India.

(iii) TDS on rent for building and machinery: Tax is deductible on rent under section 194-I, if the aggregate amount of rental income paid or credited to a person exceeds ₹ 1,80,000. Rent includes payment for use of, *inter alia*, building and machinery.

The aggregate payment made by Mac Ltd. to Ramesh towards rent in P.Y.2016-17 is ₹ 1,85,000 (i.e., ₹ 1,35,000 for building and ₹ 50,000 for machinery). Hence, Mac Ltd. has to deduct tax @10% on rent paid for building and tax @ 2% on rent paid for machinery.

(iv) TDS on compensation for compulsory acquisition: Tax is deductible at source @10% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural loan).

However, no tax deduction is required if the aggregate payments in a year does not exceed ₹ 2,50,000.

Therefore, no tax is required to be deducted at source on payment of ₹ 2,45,000 to Mr. X, since the aggregate payment does not exceed ₹ 2,50,000.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.

Question 7

LL Limited paid leave travel facility to its employees and considered exemption under section 10(5), based on the self-declaration furnished by the employees. The Assessing Officer held that the company as an employer ought to have verified the genuineness of the claim of exemption by obtaining from them, the proof of actual expenditure incurred by availing leave *travel facility. Accordingly, the Assessing Officer treated the assessee company as assessee in default. Decide the correctness of action.*

Answer

Section 192 casts liability on the employer to deduct tax at source from the salary paid to its employees.

In this case, the employer has paid leave travel concession / facility to its employees and the said concession / facility would be eligible for exemption subject to the conditions laid down in section 10(5) read with Rule 2B of the Income-tax Rules, 1962.

Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head 'Salaries' to obtain from the assessee, the evidence or proof or particulars of prescribed claims under the provisions of the Act in the prescribed form and manner for the purposes of –

(1) estimating income of the assesses; or

(2) computing tax deductible under section 192(1).

Rule 26C of the Income-tax Rules, 1962 mandates a salaried assessee claiming, *inter alia*, leave travel concession or assistance to furnish evidence of expenditure incurred in relation thereto to the person responsible for making such for payment under section 192(1), for the purpose of estimating his income for computing the tax deductible under section 192.

Thus, the action of the Assessing Officer is correct in law.

Question 8

Maya Bank credited ₹ 73,50,000 towards interest on the deposits in a separate account for macro-monitoring purposes by using Core-branch Banking Solutions (CBS) software. No tax was deducted at source in respect of interest on deposits so credited even where the interest in respect of some depositors exceeded the limit of ₹ 10,000.

The Assessing Officer disallowed 30% of interest expenditure where the interest on time deposits credited exceeded the limit of ₹ 10,000 and also levied penalty under section 271C.

Decide the correctness of action of the Assessing Officer.

Answer

The *Explanation* below section 194A(1) provides that where any income by way of interest other than interest on securities is credited to any account, whether called 'interest payable account' or 'suspense account' or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and provisions of section 194A thus shall apply.

However, the CBDT vide *Circular No.3/2010 dated 02.03.2010* has clarified that *Explanation* to section 194A will not apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software.

Since no constructive credit to the depositor's / payee's account takes place while calculating interest on daily / monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only.

In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee's requirement or on maturity or on encashment of time deposit, whichever event takes place earlier and wherever the aggregate amount of interest income credited or paid or likely to be credited or paid during the financial year by the bank exceeds the limits specified in section 194A i.e. Rs.10,000.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent initiation of penalty proceedings under section 271C is not tenable in law.

Question 9

Discuss whether tax has to be deducted at source under the provisions of the Income-tax Act, 1961 in the following situations, which have taken place during the year ended 31-3-2017:

(i) M/s. Jiva & Co., a partnership firm, pays a sum of ₹ 43,000 as interest on loan borrowed from an Indian branch of a foreign bank.

(ii) Above firm has paid ₹ 12,000 as interest on capital to partner Mr. A, a resident in India, and ₹ 24,000 as interest on capital to partner Mr. B, a non-resident.

(iii) The above firm paid Rs.50,000 being share of profit of partner Mr.B, a non-resident

Answer

(i) Section 194A requires deduction of tax on any income by way of interest, other than interest on securities, credited or paid to a resident, at the rates in force.

However, it specifically excludes from its scope, income credited or paid to any banking company to which the Banking Regulation Act, 1949 applies.

An Indian branch of a foreign bank, transacting the business of banking in India, is a banking company to which the Banking Regulation Act, 1949 applies. Therefore, interest payment to such bank will not attract tax deduction under section 194A.

Consequently, no tax is required to be deducted at source under section 194A on interest of ₹ 43,000 paid by M/s. Jiva & Co., a partnership firm, on loan borrowed from an Indian branch of a foreign bank.

(ii) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities, credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Therefore, no tax is required to be deducted at source under section 194A on interest on capital of ₹ 12,000 paid by the firm to Mr. A, a resident partner.

Section 195, which requires tax deduction at source on payments to non-residents, does not provide for any exclusion in respect of payment of interest by a firm to its non-resident partner. Therefore, tax has to be deducted under section 195 at the rates in force in respect of interest on capital of ₹ 24,000 paid to partner Mr. B, a non-resident.

(iii) As per section 10(2A), share of profit received by a partner from the total income of the firm is exempt from tax. Therefore, the share of profit paid to non-resident partner is not liable for tax deduction at source.

However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

Question 10

Mr. Govind won the first prize in a lottery ticket and the prize was a Maruti car worth ₹ 5 lacs. What is the procedure to be adopted before handing over the Maruti Car to Mr. Govind?.

Answer

Section 194B provides that the person responsible for paying to any person, any income by way of winnings from any lottery or crossword puzzle, card game or any other game of any sort and the amount of winning exceeds Rs.10,000, tax shall be deducted at source @ 30%.

However, in case where the winning is wholly in kind, the person responsible for paying the prize shall before releasing the winning, ensure that the **tax has been paid in respect of such winning**.

The Karnataka High Court in the case of *CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1* has held that where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that the tax is paid by the winner of the prize before the prize is released in his favour. In this regard, the *CBDT Circular No.763 dated 18/2/1998* clarifies that the person responsible for paying the winnings shall, before releasing such winnings, ensure that the tax is paid by the winner. He can do so, for example, by collecting from the winner a sum equal to the tax deductible at source on the winnings in kind, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind.

Therefore, in this case since the entire winning is in kind, it must be ensured that the sum equal to the tax deductible at source (i.e. ₹ 1,50,000, being @ 30% of ₹ 5 lacs) is paid by Mr. Govind, before the car is released in his favour. This can be done by collecting ₹ 1,50,000 from Mr. Govind before releasing the Maruti car to him and remitting the said sum to the Government account or verifying the tax payment by the winner and thereafter releasing the prize.

Question 11

Bharathi Cements Ltd, purchased jute bags from Raj Kumar & Co. The latter has to supply the jute bags with the logo and address of the assessee, printed on it. From 01.09.2016 to 20.03.2017, the value of jute bags supplied is ₹ 8,00,000, for which the invoice has been raised on 20.03.2017. While effecting the payment for the same, is the assessee bound to *deduct tax at source, assuming that the value of the printing component involved is ₹ 1,10,000. You are informed that the assessee has not sold any material to Raj Kumar & Co. and that the latter has to manufacture the jute bags in its plant using raw materials purchased by it from outsiders.*

Answer

As per the definition under section 194C "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer. This is regardless of the quantum of expenditure incurred towards printing or processing comprised in the bill amount.

The problem clearly states that Raj Kumar & Co. has to manufacture the jute bags using raw materials purchased from outsiders and that the assessee Bharathi Cements Ltd has not sold any material to them. Therefore, in this case, **it is a contract of sale. Hence, the provisions of section 194C is not attracted and no liability to deduct tax at source would arise**.

Question 12

Alap Ltd. has made following payments on various dates in financial year 2016-17 to Vilambit Ltd. towards work done under different contracts:

Contract Number	*Date of payment*	*Amount (₹)*
1.	*5.5.2016*	*20,000*
2.	*6.6.2016*	*15,000*
3.	*8.8.2016*	*25,000*
4.	*10.12.2016*	*25,000*
5.	*29.01.2017*	*17,000*

Alap Ltd. claims that it is not liable for deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract no. 5 is ₹ 14,000 only and there was no further contract during the year?

Answer

As per section 194C(5) tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds ₹ 30,000 in a single payment or ₹ 1,00,000 in aggregate during the financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed ₹ 30,000, the aggregate amount exceeds ₹ 1,00,000. Hence, Alap Ltd's contention is not correct and tax is required to be deducted at source on the whole amount of ₹ 1,02,000 from the last payment of ₹ 17,000 towards contract no.5 on account of which the aggregate amount exceeded ₹ 1,00,000.

However, no tax deduction is to be made if the value of the last contract is ₹ 14,000 as the aggregate amount in such case would only be ₹ 99,000, which is below the aggregate monetary limit of ₹ 1,00,000.

Question 13

B. Airways Ltd. sold tickets to the travel agents in India at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price but not exceeding the maximum published price. Commission at the rate of 9% of minimum fixed commercial price was deducted under section 194H by the company. The Assessing Officer contended that the liability for tax deduction at source is attracted on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.

Is the contention of Assessing Officer tenable in law?

Answer

As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier.

In the present case, B. Airways Ltd. correctly deducted tax at source under section 194H from the commission @ 9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contented that the airline company was required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as “additional special commission” in the hands of the agents.

The facts of the case are similar to the case of *CIT v. Qatar Airways (2011) 332 ITR 253,* where the Bombay High Court held that the difference between the maximum published price and the minimum fixed commercial price cannot be taken as “additional special commission” in the hands of the agents. This is because the maximum published price is the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price. Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. **It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.**

Applying the rationale of the above case to the case on hand, B. Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.

Therefore, the contention of the Assessing Officer is not tenable in law.

Question 14

Mahanadi Limited has taken a 3,000 sq. ft. flat on rent from Yamuna Limited to set up its Branch Office. The rent payable to Yamuna Limited for the flat is ₹ 60,000 per month plus applicable service tax. Mahanadi Limited wishes to know whether tax is required to be deducted at source under section 194-I from gross amount of rent including service tax. Give your advice.

Answer

The CBDT *Circular No.4/2008 dated 28.04.2008* has clarified that service tax paid by the tenant does not partake the nature of income of the landlord. The landlord only acts as a collecting agency of the Government for collection of service tax. Therefore, tax deduction at source under section 194-I would be required to be made on the amount of rent paid/payable **without including the service tax**.

Note *- In respect of payments other than rent, the CBDT has, vide Circular No.1/2014 dated 13.01.2014, clarified that wherever in terms of the agreement / contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid/payable without including the service tax component.*

Question 15

"Come Air Ltd." has paid a sum of ₹ 12 lakhs during the year ended 31-3-2017 to Airports Authority of India towards landing and parking charges. The company has deducted tax at source@2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment was in the nature of rent attracting TDS@10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer.

Answer

The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facility for the aircraft are for the “use of the land” by the airline company came up before the Supreme Court in *Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372*.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for use of the land of airport and hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is **not** correct.

Question 16

ABC Ltd. took on sub-lease a building from J, an individual, with effect from 1.9.2016 on a rent of ₹ 20,000 per month. It also took on hire machinery from J with effect from 1.10.2016 on hire charges of ₹ 15,000 per month. ABC Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2016-17 were ₹ 1,40,000 and ₹ 90,000, respectively, were credited by ABC Ltd. to the account of J in its books of account on 31.3.2017. Examine the obligation of ABC Ltd. with regard to deduction of tax at source in respect of the rent and hire charges.

Answer

As per section 194-I dealing with deduction of tax at source from payment of rent, the rate of TDS applicable is 2% for machinery hire charges and 10% for building lease rent. The scope of the section includes within its ambit, rent for machinery, plant and equipment. Tax is required to be deducted at source from payment of rent, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of building and machinery, irrespective of whether such assets are owned or not by the payee.

The limit of ₹ 1,80,000 for tax deduction at source will apply to the aggregate rent of all the assets. Even if two separate agreements are entered into, one for sub-lease of building and another for hiring of machinery, rent and hire charges under the two agreements have to be aggregated for the purpose of application of the threshold limit of ₹ 1,80,000. In this case, since the payment for rent and hire charges credited to the account of J, the payee, aggregates to ₹ 2,30,000 (₹ 1,40,000 + ₹ 90,000), tax is deductible at source under section 194-I. Tax is deductible @10% on ₹ 1,40,000 (rent of building) and @2%on ₹ 90,000 (hire charges of machinery).

Question 17

Mr. Harish, Vice President of ABC Bank, sold his house property in Chennai as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Suresh, a retail trader of garments, on 10.10.2016. Mr. Harish had purchased the house property and rural agricultural land in December 2013 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 10.10.2016, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively.

(a) Determine the tax implications in the hands of Mr. Harish and Mr. Suresh, if the date of agreement for sale of house property and rural agricultural land is 1.7.2016 and the stamp duty value on the said date was ₹ 75 lakh and ₹ 15 lakh, respectively. On the said date, Mr. Suresh made payment of ₹ 5 lakh by way of account payee cheque to Mr. Harish for purchase of house property. Also, discuss the TDS implications, if any, in the hands of Mr. Suresh, assuming that both Mr. Harish and Mr. Suresh are resident Indians.

(b) Would your answer be different if Mr. Harish is a property dealer and sold the house property in the course of his business?

Answer

(a) Tax implications on sale of rural agricultural land and house property representing a capital asset in the hands of Mr. Harish, a salaried employee

(i)	**Tax implications in the hands of Mr. Harish, a salaried employee**
	Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Harish. However, capital gains would arise on sale of house property, being a capital asset. As per section 50C(1), the stamp duty value of house property on the date of agreement (i.e., ₹ 75 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, ₹ 35 lakh (i.e., ₹ 75 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2017-18. It may be noted that under first and second proviso to section 50C(1), the stamp duty value on the date of agreement is to be adopted as the advance was received on the date of agreement through the specified mode. As the date of agreement is different from the date of registration and part of the consideration was received on or before the date of agreement by way of account payee cheque, the stamp duty

	value on the date of agreement is to be adopted as the deemed sale consideration.
(ii)	**Tax implications in the hands of the buyer – Mr.Suresh, a retail trader**
	The house property purchased would be a capital asset in the hands of Mr. Suresh, who is a retail trader of garments. The provisions of section 56(2)(vii) is attracted in the hands of Mr. Suresh who has acquired the immovable property, being a capital asset, for inadequate consideration. For the purpose of section 56(2)(vii), Mr. Suresh can take the stamp duty value on the date of agreement instead of the date of registration since he has paid a part of the consideration by a mode other than cash on the date of agreement. Therefore, ₹ **15 lakh,** being the difference between the stamp duty value of the property **on the date of agreement** (i.e., ₹ 75 lakh) and the actual consideration (i.e., ₹ 60 lakh) would be taxable as per section 56(2)(vii) under the head "**Income from other sources**" in the hands of Mr. Suresh. As rural agricultural land is not a capital asset, the provisions of section 56(2)(vii) are not attracted in respect of acquisition of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(vii) includes only **capital assets** specified thereunder.
(iii)	**TDS implications in the hands of the buyer, Mr. Suresh**
	Since the sale consideration of house property exceeded ₹ 50 lakh, Mr. Suresh is required to deduct tax at source under section 194-IA. The tax deduction under section 194-IA would be ₹ 60,000, being 1% of ₹ 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

(b) Tax implications on sale of house property representing stock-in-trade in the hands of Mr. Harish, a property dealer

(i)	**Tax implications in the hands of Mr. Harish for A.Y.2017-18**
	If Mr. Harish is a property dealer who has sold the house property in the course of his business, the provisions of section 43CA would be attracted, since the house property represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value.
	For the purpose of section 43CA, Mr. Harish can take the stamp duty value on the date of agreement instead of the date of registration, since he has received part of the sale consideration by a mode other than cash on the date of agreement. Therefore, **₹ 35 lakh**, being the difference between the stamp duty value on the date of agreement (i.e., ₹ 75 lakh) and the purchase price (i.e., ₹ 40 lakh), would be chargeable as **business income** in the hands of Mr. Harish.

(ii)	**TDS implications and taxability in the hands of Mr. Suresh for A.Y.2017-18**
	There would be no difference in the TDS implications or taxability in the hands of Mr. Suresh, whether Mr. Harish is a property dealer or a salaried employee. Therefore, the provisions of section 56(2)(vii) would be attracted in the hands of Mr. Suresh who has received house property, being a capital asset, for inadequate consideration. The TDS provisions under section 194-IA would also be attracted since the actual consideration for house property exceeds ₹ 50 lakh.

Question 18

Siddharth Hospitals Pvt. Ltd., has recently been accorded recognition by several insurance companies to admit and treat patients on cashless hospitalization basis. Payment to the assessee hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make payments to the various hospitals including the assessee. All TPAs are corporate entities. The assessee wants to know whether the TPAs are bound to deduct tax at source under section 194J or under section 194C?

Answer

This issue has been clarified by the CBDT *Circular No.8/2009 dated 24.11.2009*. As per provisions of section 194J(1), any person, who is responsible for paying to a resident any sum by way of fees for professional services, shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 10% of such sum as TDS.

Further, as per *Explanation* (a) to section 194J "professional services" includes services rendered by a person in the course of carrying on medical profession.

The services rendered by hospitals to various patients are primarily medical services and, therefore, **the provisions of section 194J are applicable on payments made by TPAs to hospitals** etc. Further, for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore, TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including Cashless Schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc.

In view of the above, all such transactions between TPAs and hospitals would fall within the ambit of provisions of section 194J.

Question 19

Explain in the context of provisions contained in Chapter XVII of the Act and also work out the amount of tax to be deducted by the payer of income in the following cases:

(i) Payment of ₹ 5 lacs made by JCP & Co. to Pingu Events Co. Ltd. for organizing a debate competition on the subject "Preservation of Rural Heritage of Rajasthan".

(ii) "Profit Commission" of ₹ 1 lac paid on 10.6.2016 by a re-insurance company to the insurer company after the expiry of the term of insurance and where there was no claim during the treaty.

(iii) KD, a part time director of DAF Pvt. Ltd. was paid an amount of ₹ 2,25,000 as fees which was actually in the nature of commission on sales for the period 01-04-2016 to 30-06-2016.

Answer

(i) The services of Event Managers in relation to sports activities alone have been notified by the CBDT as "professional services" for the purpose of section 194J. In this case, payment of ₹ 5 lacs was made to an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @ 2% under section 194C. The tax deductible under section 194C would be ₹ 10,000, being 2% of ₹ 5 lacs.

(ii) Section 194D requires deduction of tax at source @5% from insurance commission, where the commission exceeds ₹15,000.

Reinsurance is different from insurance since there is no direct contractual relationship between the person insured and the re-insurer.

In order to attract section 194D, the commission or any other payment covered under the section should be a remuneration or reward for soliciting or procuring the insurance business. The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there is no claim during the operation of the reinsurance treaty, tax deduction under section 194D is not attracted.

(iii) Section 194J provides for deduction of tax at source @10% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @10% by DAF Pvt. Ltd. on the commission of ₹ 2,25,000 paid to KD, a part-time director. The tax deductible under section 194J would be ₹ 22,500, being 10% of ₹ 2,25,000.

Question 20

East Bengal Club, a renowned football club, has engaged Raghu, a resident in India, as its coach at a remuneration of ₹ 6 lacs per annum. The club wants to know from you whether it is liable to deduct tax at source from such remuneration.

Answer

Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds ₹ 30,000 in a financial year. As per *Explanation* (a) to section 194J, professional services includes services rendered by a person in the course of carrying on such other profession as is notified by the CBDT for the purposes of section 194J.

Accordingly, the CBDT has, vide *Notification No.88 dated 21.8.2008*, in exercise of the powers conferred by clause (a) of the *Explanation* to section 194J has notified the services rendered by coaches and trainers in relation to the sports activities as professional services for the purposes of section 194J.

Therefore, the club is liable to deduct tax at source under section 194J from the remuneration payable to the Coach, Raghu.

Question 21

Explain the applicability of the provisions relating to deduction of tax at source in the following transactions:

(i) *Max Limited pays ₹ 1,02,000 to Mini Limited, a resident contractor who, under the contract dated 15th October, 2016, manufactures a product according to specification of Max Limited by using materials purchased from Max Limited.*

(ii) *A company operating a television channel makes payment of ₹ 5 lacs to a former cricketer for making running commentary of a one-day cricket match.*

(iii) *EL Ltd., a foreign company, pays outside India, salary to its employee, Mr. Raghavan, a foreign national and a non-resident, for services rendered in India.*

Answer

(i) The definition of "work" under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In the instant case, Mini Limited manufactures the product as per the specification given by Max Limited **by using the raw materials purchased from Max Limited**. **Therefore, it falls within the definition of "work"** under section 194C. Consequently, tax is to be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.

(ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds ₹ 30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as a professional service for the purposes of section 194J vide its *Notification No. 88 dated 21st August, 2008.* Therefore, tax is required to be deducted@10% from the fee of ₹ 5 lacs payable to the former cricketer.

(iii) Section 195 requires deduction of tax at source by any person responsible for making payment to a non-resident, any interest or any other sum chargeable under the provisions of the Income-tax Act, 1961 (other than income chargeable under the head "Salaries").

Section 192(1) requires "any person" responsible for paying income under the head "Salaries" to deduct tax at source. Therefore, even if the payer is a foreign company, section 192 would be applicable.

TDS provisions under section 192 are attracted, if the salary payable to a non-resident is chargeable to tax in India. Under section 9(1)(ii), income which falls under the head "Salaries" shall be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India shall be regarded as income earned in India. Therefore, salary paid to Mr. Raghavan, a non-resident, attracts tax liability in India, as he has rendered services in India and the salary is attributable to such services.

Therefore, the foreign company, EL Limited, is liable to deduct tax at source under section 192 from the salary of Mr. Raghavan.

Question 22

Examine in the following cases the obligation of the person paying the income in respect of tax deduction at source and indicate the due date for payment of such tax, wherever applicable:

(i) MNO Ltd., the employer, credited salary due for the financial year 2016-17 amounting to ₹ 3,40,000 to the account of Q, an employee, in its books of account on 31.3.2017. Q has not furnished any information about his income/loss from any other head or proof of investments/payments qualifying for deduction under section 80C.

(ii) T, an individual whose total sales in business during the year ended 31.3.2016 was ₹ 1.20 crores, paid ₹ 9 lacs by cheque on 1.1.2017 to a contractor (an individual), for construction of his factory building. No amount was credited earlier to the account of the contractor in the books of T.

(iii) BCD Ltd. credited ₹ 28,000 towards fees for professional services and ₹ 27,000 towards fees for technical services to the account of HG in its books of account on 6.10.2016. The total sum of ₹ 55,000 was paid by cheque to HG on 18.12.2016.

Answer

(i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. MNO Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q which is not paid.

If salary has been paid during the year to Q, then, MNO Ltd has to obtain from Q, the evidence/proof/particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in such form and manner as may be prescribed.

If Q has not furnished any information about his income/loss under any other head or proof of investments/expenditure qualifying for deduction under section 80C, then, the employer has to deduct tax without considering any claim for any expenditure or set-off of losses or deduction under section 80C.

(ii) An individual who is liable for tax audit under section 44AB in the immediately preceding financial year is liable to deduct tax at source under section 194C for the financial year 2016-17 in respect of the payment made to contractor exceeding ₹ 30,000 in a single contract and ₹ 1,00,000 in aggregate of contracts during the financial year. Turnover of the individual T exceeded ₹ 1 crore in the financial year 2015-16. Therefore, T is liable to get his accounts for that year audited under section 44AB. As the payment during financial year 2016-17 to the contractor has exceeded the limits prescribed in section 194C, tax has to be deducted under section 194C.

The rate of tax deduction is 1% as the contractor is an individual.

(iii) The limit of ₹ 30,000 for non-deduction of tax under section 194J would apply separately for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fee for each category does not exceed ₹ 30,000 even though the aggregate of the amounts credited to the account of such person or paid to him for both the categories of services exceed ₹ 30,000. Therefore, BCD Ltd. is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.

Question 23

Discuss the liability for tax deduction at source in the following cases for the assessment year 2017-18:

(i) Mr. Anand has been running a sole proprietary business whose accounts are audited under section 44AB with turnover which exceeded Rs.100 lakhs for the A.Y 2016-17. He pays a monthly rent of ₹ 10,000 for the office premises to Mr. R, the owner of building and an individual. Besides, he also pays service charges of ₹ 6,000 per month to Mr. R towards the use of furniture, fixtures and vacant land appurtenant thereto.

(ii) By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of ₹ 50,000 per month towards supply of food, water, snacks etc. during office hours to the employees of the bank.

(iii) An Indian company pays gross salary including allowances and monetary perquisites amounting to ₹ 6,80,000 to its General Manager. Besides, the company provides non-monetary perquisites to him whose value is estimated at ₹ 1,20,000.

(iv) A notified infrastructure debt fund eligible for exemption under section 10(47) of the Income-tax Act, 1961 pays interest of ₹ 5 lakhs to a company incorporated in USA. The US Company incurred expenditure of ₹ 12,000 for earning such interest. The fund also pays interest of ₹ 3 lakhs to Mr. X, who is a resident of a notified jurisdictional area.

Answer

(i) Where the payer is an individual or HUF whose accounts were audited for the preceding financial year as per the provisions of section 44AB, he has to deduct tax at source. As the accounts of Mr. Anand are subjected to tax audit for the assessment year 2016-17 under section 44AB of the Income-tax Act, 1961, he is liable to deduct tax at source under section 194-I in respect of rental payments during the financial year 2016-17.

Accordingly, Mr. Anand is liable to deduct tax at source under section 194-I on the rental payments made. Section 194-I provides that rent includes any payment, by whatever name called, for the use of land or building together with furniture, fittings etc. Therefore, in the given case, apart from monthly rent of ₹10,000 p.m., service charge of ₹ 6,000 p.m. for use of furniture and fixtures would also attract TDS under section 194-I. Since the aggregate rental payments to Mr. R during the financial year 2016-17 exceeds ₹ 1,80,000, Mr. Anand is liable to deduct tax at source @10% under section 194-I from rent paid to Mr. R.

(ii) The definition of "work" under *Explanation* to section 194-C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds ₹ 30,000, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation under 194-C. If the catering organization is an individual or HUF, then the tax deduction shall be @ 1%.

(iii)

	₹
Gross salary, allowances and monetary perquisites	6,80,000
Non-Monetary perquisites	1,20,000
	8,00,000
Tax Liability	87,550
Average rate of tax (₹ 87,550 / ₹ 8,00,000 × 100)	10.9438%

The company can deduct ₹ 87,550 at source from the salary of the General Manager. Alternatively, the company can pay tax on non-monetary perquisites as under –

Tax on non-monetary perquisites = 10.9438% of ₹ 1,20,000 = ₹ 13,133

Balance to be deducted from salary = ₹ 74,417

If the company pays tax of ₹ 13,313 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a). The amount of tax paid towards non monetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).

(iv) As per section 194LB, tax would be deductible @ 5% on gross interest paid/credited by a notified infrastructure debt fund, eligible for exemption under section 10(47), to a foreign company.

In the first case, since the payment is to a foreign company, education cess @ 2% and secondary higher education cess @1% have to be added to the applicable rate of TDS. Therefore, the tax deductible under section 194LB would be ₹ 25,750 (i.e., 5.15% of ₹ 5 lakhs).

However, in case the notified infrastructure debt fund pays interest to a person who is a resident of a notified jurisdictional area, section 94A will apply. Accordingly, tax would be deductible @30% (plus education cess@2% and secondary and higher education cess@1%) under section 94A, even though section 194LB provides for deduction of tax at a concessional rate of 5%. Therefore, the tax deductible in respect of payment of ₹ 3 lakh to Mr. X, who is a resident of a notified jurisdictional area, would be ₹ 92,700, being 30.9% of ₹ 3,00,000.

Question 24

The following issues arise in connection with the deduction of tax at source under Chapter XVII-B. Discuss the liability for tax deduction in these cases:

(a) An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.

(b) A T.V. channel pays ₹ 10 lakh on 1.9.2016 as prize money to the winner of a quiz programme, "Who will be a Millionaire"?

(c) State Bank of India pays ₹ 50,000 per month as rent to the Central Government for a building in which one of its branches is situated.

(d) A television company pays ₹ 80,000 to a cameraman for shooting of a documentary film.

(e) A State Government pays ₹ 22,000 on 2.7.2016 as commission to one of its agents on sale of lottery tickets.

(f) A Turf Club awards a jack-pot of ₹ 5 lakh to the winner of one of its races on 1.2.2017.

Answer

(a) As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head 'Salaries'. However, under sub-section (2A) of that section, the employee will be entitled to relief under section 89 and consequently he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e. Form No.10E). The person responsible for making the payment shall compute the relief and take into account the same while deducting tax at source from salary.

(b) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding ₹ 10,000 shall at the time of payment deduct income-tax at 30%. Therefore, tax of Rs.3 lakh has to be deducted at source from the prize money of ₹ 10 lakh payable to the winner.

(c) Section 194-I, which governs the deduction of tax at source on payment of rent, exceeding ₹ 1,80,000 per annum is applicable to all taxable entities except individuals and HUFs, who were not subjected to tax audit under section 44AB in the immediately preceding financial year. Section 196, provides exemption in respect of payments made to Government from application of the provisions of tax deduction at source.

Therefore, no tax is required to be deducted at source by State Bank of India from rental payments to the Government.

(d) If the cameraman is an employee of the T.V. Company, the provisions of section 192 will apply. However, if he is a professional, TDS provisions under section 194-J will apply. Tax at 10% will have to be deducted at the time of credit of ₹ 80,000 or on its payment, whichever is earlier.

(e) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than ₹ 15,000, deduct income-tax at source @5%.

Accordingly, tax@5% under section 194G amounting to ₹ 1,100 has to be deducted from commission payment of ₹ 22,000 to the agent of the State Government.

(f) The payment by way of winnings from horse race is governed by section 194BB. Under this section, the person responsible for payment shall, at the time of payment, deduct tax at source @ 30%, if the payment exceeds ₹ 10,000.

Accordingly, tax@30% amounting to ₹ 1,50,000 has to be deducted from the winnings of ₹ 5 lakh payable to the winner of the race.

Question 25

Discuss and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31st March, 2017.

(i) *Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of ₹ 90 lakhs, on 20.6.2016. On the same day, Mr. X made two separate transactions, thereby acquiring an urban plot in Kolkata from Mr. C for a sum of ₹ 49,50,000 and rural agricultural land from Mr. D for a consideration of ₹ 60 lakhs.*

(ii) *On 17.6.2016, a commission of ₹ 50,000 was retained by the consignee 'ABC Packaging Ltd.' and not remitted to the consignor 'XYZ Developers', while remitting the sale consideration. Examine the obligation of the consignor to deduct tax at source.*

(iii) *Mr. S won a motor car in a lucky draw held by 'P' marketing. The market price of car was ₹ 4,00,000. P marketing erroneously gave the car to Mr. S without deducting tax at source. Examine the liability of P marketing to make such payment, if any.*

(iv) *Raj is working with AB Ltd. He is entitled to a salary of ₹ 45,000 per month w.e.f. 1.4.2016. He has a house property which is self-occupied. He paid an interest of ₹ 80,000 on loan,*

during the previous year 2016-17. The loan was taken for construction of house. He has notified his employer AB Ltd. that there will be a loss of ₹ 80,000 in respect of this house property for financial year ended 31.3.2017.

Answer

		Amount of TDS (₹)
(i)	Since the consideration for transfer of house property at Mumbai exceeds ₹ 50 lakhs, Mr. X, being the transferee, is required to deduct tax @1% under section 194-IA on ₹ 90 lakhs, being the amount of consideration for transfer of property.	90,000
	Mr. X is not required to deduct tax as source under section 194-IA from the consideration of ₹ 49,50,000 paid to Mr. C for transfer of urban plot, since the consideration is less than ₹ 50 lakhs.	Nil
	Mr. X is also not required to deduct tax at source under section 194-IA from the consideration of ₹ 60 lakhs paid to Mr. D for transfer of rural agricultural land, since the same is specifically excluded from the scope of immovable property for the purpose of tax deduction under section 194-IA.	Nil
	Note *- Section 194-IA requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property is less than ₹ 50 lakhs.*	
(ii)	Section 194H requires deduction of tax at source @5% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed ₹ 15,000.	
	In the given case, 'ABC Packaging Ltd.', the consignee, has not remitted the commission of ₹ 50,000 to the consignor 'XYZ Developers' while remitting the sales consideration.	
	Since the retention of commission by the consignee/agent amounts to constructive payment of the same to him by the consignor/principal, deduction of tax at source is required to be made from the amount of commission *[CBDT Circular No.619 dated 4/12/1991].*	
	Therefore, XYZ Developers has to deduct tax at source on ₹ 50,000 at the rate of 5%.	2,500

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Section 194B provides that the person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzle, card game and any other game of any sort in an amount exceeding ₹10,000 shall deduct tax at source @ 30%.
However, in case where winnings are wholly in kind, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings. Where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that tax is paid by the winner of the prize before the prize is released in his favour.
This can be done, by collecting from the winner, a sum equal to the tax deductible at source on the winnings in kind and, thus, meeting the liability for TDS, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind [Circular No.763 dated 7/2/1998]
In the given case, P marketing has released the car without ensuring tax payment of ₹ 1,20,000, being 30% of ₹ 4,00,000 (being the value of car) by Mr. S.
P Marketing is therefore liable for penalty under section 271C and prosecution under section 276B [CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1 (Kar.)]
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Section 192 provides that tax is required to be deducted on the payment made as salaries. Tax is to be deducted on the estimated income at the average of income tax computed on the basis of the rates in force for the financial year in which payment is made.
The employee may declare details of his other incomes (including loss under the head “Income from house property” but not any other loss) to his employer. In this case, since Mr. Raj has notified his employer AB Ltd. of loss from self-occupied house property, the employer has to take the same into consideration for deduction of tax at source.
Therefore, AB Ltd. is required to deduct tax at source on the salary of ₹ 45,000 per month paid to Mr. Raj, in the following manner:
<table>
<tr><td>Income under the head salaries (45,000 x 12)</td><td>5,40,000</td></tr>
<tr><td>Income under the head “house property”</td><td>(80,000)</td></tr>
<tr><td>Gross total income</td><td>4,60,000</td></tr>
<tr><td>Less: Deduction under Chapter VI-A</td><td>Nil</td></tr>
<tr><td>Total Income</td><td>4,60,000</td></tr>
<tr><td>Tax@10% on ₹ 2,10,000, being the amount arrived at after reducing the basic exemption limit of ₹ 2,50,000 from ₹ 4,60,000</td><td>21,000</td></tr>
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	Less: Rebate under section 87A	5,000	
		16,000	
	Add: Education cess@2% and secondary and higher education cess@1%	480	
	Tax to be deducted at source	**16,480**	16,480

Question 26

A foreign company seconded some employees to the assessee, an Indian collaborator. These employees worked with the Indian collaborator throughout the P.Y.2016-17. The employees were in receipt of salary from the Indian collaborator. They were also in receipt of special allowance directly from the foreign company in foreign currency outside India. The Indian collaborator deducted tax under section 192, on the component of salary paid by it, without taking into account the special allowance paid abroad by the foreign company in foreign currency to these employees. For this reason, the Revenue authorities treated the Indian collaborator as an 'assessee-in-default' under section 201 for non-deduction of tax at source on the "special allowance" component of salary paid by the foreign company.

Is such treatment by the Revenue Authorities and the consequent levy of interest and penalty justified?

Answer

Section 9(1)(ii) provides that any income which falls under the head "salaries" is deemed to accrue or arise in India, if it is earned in India. The *Explanation* thereto further clarifies that income payable for services rendered in India shall be regarded as income earned in India.

Section 192(1) requires the person responsible for paying any income chargeable under the head "Salaries" to deduct income-tax, at the time of payment, at the average rate of income-tax computed on the basis of the rates in force for the financial year on the amount payable.

Since the TDS provisions relating to payment of income chargeable under the head "Salaries" form an integrated code along with the charging and computation provisions under the Act, section 192(1) has to be read with section 9(1)(ii) and the *Explanation* thereto. Therefore, if any payment under the head "Salaries" falls within section 9(1)(ii), then TDS provisions under section 192 gets attracted. Consequently, the Indian tax deductor assessee is duty bound to deduct, from the portion of salary paid by it, tax at source under section 192(1) on the entire salary paid to the employee, including special allowance paid abroad to the employee by the foreign company.

It was so held by the Apex Court in *CIT, New Delhi v. Eli Lilly & Co. (India) P. Ltd. (2009) 312 ITR 225.*

In this case, all the employees are resident in India, since they have worked with the Indian collaborator throughout the previous year 2016-17. If the tax due on special allowance received from the foreign company is paid by the recipient-employees, then, the Indian collaborator would not be treated as an assessee-in-default under section 201(1), if these resident-employees have furnished a return of income under section 139 on or before the due date of filing return of income, disclosing such income, and have also furnished a certificate to this effect from an accountant in the prescribed form. However, interest under section 201(1A)@1% per month or part of month shall be payable by the Indian collaborator from the date on which such tax was deductible to the date of furnishing of return by such resident employee.

In cases where the tax has not been paid by the recipient employee, the Assessing Officer can proceed under section 201(1) to recover the shortfall in payment of tax and interest thereon under section 201(1A).

However, no penalty under section 271C would be attracted, if the Indian collaborator was under the genuine and *bona fide* belief that it was not under any obligation to deduct tax at source from the special allowance paid by the foreign company. This is provided for under section 273B.

Question 27

In order to overcome a situation where tax is deducted at a rate prescribed in the relevant Double Taxation Avoidance Agreement which is higher than the rate prescribed in the Income-tax Act, 1961, CBDT has clarified this issue, to avoid genuine hardship faced by the resident deductor. Explain, in brief, the contents of this CBDT circular.

Answer

The CBDT had issued *Circular No.7/2007, dated 23.10.2007* laying down the procedure for refund of tax deducted at source under section 195 to the person deducting tax at source from the payment to a non-resident. The Circular allowed refund of tax deducted at source to the person making payment to a non-resident in certain circumstances. For example, if the income does not accrue to the non-resident or if the income is accruing, no tax is due but tax has been deducted, or tax has been deducted at a higher rate specified in the Income-tax Act, 1961, whereas it is deductible at a lower rate under the relevant DTAA.

A similar situation arises in a case where tax is deducted at a rate prescribed in the relevant DTAA which is higher than the rate prescribed in the Income-tax Act, 1961. This situation is, however, not included in the list of circumstances covered under the above Circular of the CBDT. Since the law requires deduction of tax at a rate prescribed in the relevant Double Taxation Avoidance Agreement (DTAA) or under the Income-tax Act, 1961, whichever is lower, there is a possibility that in such cases, excess tax is deducted relying on the provisions of relevant DTAA.

Accordingly, in order to remove the genuine hardship faced by the resident deductor, the CBDT has, vide *Circular No. 7/2011 dated 27-09-2011*, modified *Circular No.07/2007, dated 23.10.2007* to the effect that the beneficial provisions under the said Circular allowing refund of excess tax deducted at source under section 195 to the deductor shall also apply to those cases where tax has been deducted at source at a higher rate as mentioned in the relevant DTAA while a lower rate is prescribed under the domestic law.

Question 28

A sum of ₹ 60,000 was paid to Mr. Dastur, an advocate, on 1st July, 2016 towards fees for his professional services without deducting tax at source. Later on, a further sum of ₹ 70,000 was *due to him on 28th February, 2017 from which tax of ₹ 13,000 was deducted at source. The tax so deducted was deposited on 25th June, 2017. Compute interest payable by the deductor under section 201(1A).*

Answer

In this case, tax is deductible@10% under section 194J in respect of fees for professional services. Since there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.

As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by the Act, then he is liable to pay interest as follows -

(i) 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted.

(ii) 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

Therefore, in the given case, interest under section 201(1A) would be computed as follows –

	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 6,000 for 8 months	480
1½% on tax deducted but not deposited i.e. 1½% on ₹ 13,000 for 4 months	780
Total interest payable under section 201(1A)	1,260

Question 29

Apple Iron Ltd. paid ₹ 10 lakhs to a lawyer on 01-08-2016 for the professional services rendered by him to the company, without deducting tax at source. Again another payment of ₹ 5 lakhs was due on 31-12-2016. The company deducted tax at source before making payment on 31-12-2016 for the entire amount of ₹ 15 lakhs.

The tax deducted at source was, however, remitted by the company on 28th March, 2017.

Compute the interest chargeable under section 201(1A) of the Income-tax Act, 1961.

Answer

Computation of interest chargeable under section 201(1A)

As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by or under the Act, then he is liable to pay simple interest as follows -

@ 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted; and

@ 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

In this case, tax is deductible@10% under section 194J in respect of fees for professional services. Tax of ₹ 1 lakh (10% of ₹ 10 lakh) was deductible on 1.8.2016 but actually deducted on 31.12.2016. Tax of ₹ 1.50 lakhs [10% of ₹ 15 lakh (i.e., ₹ 10 lakh + ₹ 5 lakh)] deducted on 31.12.2016 was paid only on 28.3.2017. Since there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.

Therefore, in the given case, interest under section 201(1A) would be computed as under:

Particulars	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 1,00,000 for 5 months (from 01.08.2016 to 31.12.2016)	5,000
1½% on tax deducted but not deposited i.e., 1½% on ₹ 1,50,000 for 3 months (from 31.12.2016 to 28.03.2017)	6,750
Total interest payable under section 201(1A)	**11,750**

Question 30

Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the submission of the company.

M/s Soft Drinks Limited entered into an agreement for the warehousing of its products with XYZ Warehousing and deducted tax at source as per provisions of section 194C out of warehousing charges paid during the year ended on 31.03.2016. The Assessing Officer, while completing the assessment for A.Y. 2016-17 of Soft Drinks Limited in March 2017, treated the warehousing charges as rent as defined in section 194-I and asked the company to make payment of difference amount of TDS with interest. It was submitted by the company that the recipient had already paid tax on the entire amount of warehousing charges and therefore, now the difference amount of TDS cannot be recovered. However, it will make the payment of due interest on the difference amount of TDS.

Answer

Section 201 provides that the payer (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee –

(1) has furnished his return of income under section 139;

(2) has taken into account such sum for computing income in such return of income; **and**

(3) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the resident payee.

However, where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident and is not deemed to be an assessee-in-default under section 201(1) as mentioned above, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such resident payee.

Therefore, M/s Soft Drinks Limited shall not be required to pay the difference tax in case the above mentioned conditions are fulfilled. However, the assessee shall be liable to make payment of interest from the date on which such tax was deductible to the date of furnishing of return of income by XYZ Warehousing.

Therefore, the submission of the assessee company, in this case, is correct.

Question 31

M, an individual, had let out his building on a monthly rent of ₹ 20,000. The tenant deducted tax under section 194-I from the rent paid to M, but did not remit such tax to the credit of the Central Government. M filed his return of income for the assessment year 2017-18 including therein the rental income from the said building and paid the balance tax on his total income after taking credit for tax deducted at source by the tenant. The Assessing Officer has called upon M to pay the tax to the extent of tax deducted at source. Is the Assessing Officer justified in doing so?

Answer

Section 205 of the Income-tax Act, 1961 provides that where tax is deductible at source under the provisions of Chapter XVII, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income. Section 205, therefore, bars a direct demand being made on an assessee to the extent of tax deducted from the income. The Income-tax Department can recover the tax deducted at source from the tenant and not from M in view of the clear mandate in section 205.

The Karnataka High Court has, in *Smt. Anusuya Alva v. DCIT (2005) 278 ITR 206,* ruled that tax deducted at source by the tenant from the rent paid but not remitted to the credit of the Central Government can be recovered only from the tenant and not from the landlord. Therefore, in view of the clear mandate in section 205, the Assessing Officer is not justified in law in calling upon M to pay the said tax.

Question 32

What are the consequences of not collecting tax at source (TCS) in respect of sale of scrap by a manufacturing company? State the circumstances under which the TCS provisions are not applicable in the above case.

Answer

As per section 206C, every person being a seller of, *inter alia,* scrap, shall, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount from the buyer, whichever is earlier, collect tax at source@1% of the said amount from the buyer. If the seller does not collect tax at source on sale of scrap, then, the following would be the consequences:

(i) He shall be deemed to be an assessee in default in respect of the tax not collected.

(ii) He shall be liable to pay the tax, which he ought to have collected, to the credit of the Central Government, even if he has not actually collected the tax.

(iii) He shall be liable to pay simple interest at the rate of 1% per month or part thereof on the amount of such tax from the date on which such tax was collectible to the date on which the tax was actually paid and such interest shall be paid before furnishing the quarterly statement for each quarter.

(iv) Penalty equal to the amount of tax which is not collected can be levied under section 271CA.

Note: *However, the seller who does not collect tax at source shall not be deemed to be an assessee in default in respect of such tax if the buyer –*

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

In such cases, the buyer shall be liable to pay interest from the date on which such tax was collectible to the date of furnishing of return of income by such buyer.

The seller, however, would not be liable to collect tax at source in the following cases:

(i) If the buyer is a resident and he furnishes to the person responsible for collecting tax, a declaration in the prescribed form to the effect that scrap is to be utilized for the purpose of manufacturing, processing or producing articles or things or for the purposes of generation of power and <u>not for trading purposes</u>.

(ii) If scrap is sold to a public sector company, the Central Government, a State Government, an embassy, a High Commission, legation, commission, consulate and the trade representation of a foreign State or a club.

(iii) If the buyer, in the retail sale of scrap, has purchased the scrap for his personal consumption.

Question 33

The procedure relating to the recovery of tax due or the arrears of taxes from a non-resident is different than the resident assessee. Comment and state how such recovery is to be made along with its limitation.

Answer

The provisions for recovery of tax in respect of non-residents are contained in section 173. According to this section, the tax chargeable on the income, which is deemed to accrue or arise in India under section 9(1)(i), in the name of the non-resident or his agent who is liable as a representative assessee, maybe recovered by deduction of tax at source under any of the provisions of Chapter XVII-B.

Any arrears of tax may be recovered also in accordance with the provisions of the Income-tax Act, 1961. However, the limitation contained in section 173 is that such recovery can be made only from any assets of the non-resident which are within India or which may at any time come within India.

Note: *The provisions for recovery of tax in respect of non-residents and the limitation thereto required for in the question can be answered on the basis of the provisions of section 173.*

However, students may note that in a case where the Central Government has entered into an agreement for recovery of tax with the Government of the country where the non-resident resides, the provisions of section 228A provide for an exception to the limitation contained in section 173.

Under section 90A(1), the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India for, inter alia, recovery of income-tax under the Income-tax Act, 1961 and under the corresponding law in force in that country or specified territory.

Section 228A provides for the procedure of recovery of tax in pursuance of an agreement entered into by the Central Government with the Government of any country outside India. Sub-section (2) thereof provides that where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee has property in a country outside India, forward to the Board a certificate drawn up by him under section 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

Question 34

PA Consulting (P) Ltd., an Indian company established in the year 2000, reports total income of ₹ 10,50,000 for the previous year ended 31[st] March, 2017. Tax deducted at source by different payers amounted to ₹ 24,450 and tax paid in foreign country on a doubly taxed income amounted to ₹ 10,000 for which the company is entitled to relief under section 90 as per the double taxation avoidance agreement.

During the year the company paid advance tax as under:

Date of payment	***Advance tax paid (₹)***
15-06-2016	*40,000*
12-09-2016	*65,000*

15-12-2016	*1,00,000*
15-03-2017	*62,000*

The company filed its return of income for the A.Y. 2017-18 on 15th October, 2017.

Compute interest, if any, payable by the company under sections 234A, 234B and 234C. Assume that transfer pricing provisions are not applicable.

Answer

Interest under section 234A

Since the return of income has been furnished by PA Consulting Ltd. on 15th October, 2017 i.e. 15 days after the due date for filing return of income (30.9.2017), interest under section 234A will be payable for 1 month @ 1% on the amount of tax payable on the total income, as reduced by tax reliefs and prepaid taxes.

Particulars	₹
Tax on total income (₹ 10,50,000 x 30.9%)	3,24,450
Less: Advance tax paid	2,67,000
Less: Tax deducted at source	24,450
Less: Relief of tax allowed under section 90	10,000
Tax payable on self assessment	**23,000**
Interest = ₹ 23,000 x 1% = ₹ 230	

Interest under section 234B

Where the advance tax paid by the assessee is less than 90% of the assessed tax, the assessee would be liable to pay interest under section 234B.

Computation of Assessed tax:	₹
Tax on total income (₹ 10,50,000 x 30.9%)	3,24,450
Less: Tax deducted at source	24,450
Less: Relief of tax allowed under section 90	10,000
Assessed tax	**2,90,000**
90% of assessed tax = ₹ 2,90,000 x 90% = ₹ 2,61,000	

Since the advance tax paid by PA Consulting Ltd. (₹ 2,67,000) is more than 90% of the assessed tax (₹ 2,61,000), it is not liable to pay interest under section 234B.

Interest under section 234C

Particulars	₹
Tax on total income (₹ 10,50,000 x 30.9%)	3,24,450
Less: Tax deducted at source	24,450

Less: Relief of tax allowed under section 90	10,000
Tax due on returned income/Total advance tax payable	**2,90,000**

Calculation of interest payable under section 234C:

Date (a)	Advance tax paid till date (b) (₹)	Minimum % of tax due on returned income to be paid till date to avoid interest under section 234C (c)		Advance tax payable till date in case condition mentioned in (c) is not met	Short-fall	Interest
		%	Amount (₹)		(₹)	(₹)
15.06.2016	40,000	12%	34,800	15%	-	Nil **(See Note below)**
15.09.2016	1,05,000	36%	1,04,400	45%	-	Nil **(See Note below)**
15.12.2016	2,05,000	75%	2,17,500	75%	12,500	12,500 x 1% x 3 months = 375
15.03.2017	2,67,000	100%	2,90,000	100%	23,000	23,000 x 1% = 230
Interest payable under section 234C (Nil + Nil + ₹ 375 + ₹ 230)						**₹ 605**

Note: *Since the advance tax paid by PA Consulting (P) Ltd. on 15th June, 2016 is more than 12% of the tax due on returned income (i.e., ₹ 2,90,000) and the advance tax paid on 12th September, 2016 is more than 36% of the tax due on returned income, it is not liable to pay any interest under section 234C in respect of these two quarters.*

Exercise

1. *Discuss the provisions of section 194LA relating to TDS from compensation paid on acquisition of immovable property other than agricultural land.*
2. *Explain the terms "buyer", "scrap" and "seller" as defined under Explanation to section 206C of the Income-tax Act, 1961.*
3. *What are the prescribed modes of recovery of tax by the Tax Recovery Officer under the provisions of the Income-tax Act, 1961?*
4. *Discuss the employer's liability to deduct tax at source from the salary paid to a non-resident employee and the consequences, if any, for failure to deduct tax at source.*
5. *ABC Ltd. failed to deduct tax at source under section 194J in respect of fees for professional services paid by it. The Assessing Officer levied penalty under section 271C for failure to deduct*

tax at source. In addition, the Assessing Officer also levied penalty under section 272A(2)(c) for failure to furnish return under section 206 and under section 272A(2)(g) for failure to furnish certificate of tax deducted at source as per the requirement of section 203. Is the action of the Assessing Officer correct in law?

6. *Section 206C casts responsibility on the seller to collect tax at source, inter alia, on sale of alcoholic liquor for human consumption at the rate of 1% of "such amount" received from the buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier. Whether collection of tax at source under section 206C would be on the price of liquor, including excise duty paid for purchase of liquor? You are required to answer this question with the aid of a case law.*

7. *Can stamp vendors be treated as agents of the Government for marketing stamp papers? If yes, can tax be deducted under section 194H in respect of discount given on sale of stamps by the Treasury to the stamp vendor?*

Answers

5. This issue came up before the High Court of Allahabad in *CIT-II, Lucknow vs. Sahara India Financial Corporation Ltd. (2007) 158 Taxman 0435.* The High Court held that the provisions of sections 203 and 206 would be applicable only if tax has been deducted at source by the person concerned and he commits default in complying with any of the provisions of section 203 or 206. However, in a case where no tax has been deducted at source, the aforesaid provisions would not be attracted. For failure of the assessee in deducting tax at source, penalty can be imposed upon him under section 271C. Once a person concerned has been subjected to a penalty under section 271C for not deducting tax at source, there would not arise any occasion for levying penalty under section 272A(2)(c) and 272A(2)(g) for non-compliance of the provisions of sections 206 and 203. In other words, in case the tax has not been deducted at source, the question of issuing the certificate of tax deducted under section 203 and that of filing of return under section 206 would not arise at all. Therefore, the question of imposing penalty for violation of the provisions of section 203 and 206 would also not arise.

Therefore, the action of the Assessing Officer imposing penalty under sections 272A(2)(c) and 272A(2)(g) in a case where tax has not been deducted at source is not correct in law.

6. This issue was answered by the High Court of Madhya Pradesh in *Vinod Rathore vs. Union of India (2005) 278 ITR 122*. The question for consideration before the Court was whether collection of tax at source under section 206C on the price of liquor shall include excise duty paid for purchase of liquor. The High Court held that the purchase price would include the excise duty paid by the buyer and collection of tax at source under section 206C on the price of liquor shall include excise duty paid for purchase of liquor.

7. In *CIT v. Ahmedabad Stamp Vendors Association (2012) 348 ITR 378 (SC)*, it was held that the stamp vendors cannot be treated as agents of the Government and discount given on sale of stamps by the Treasury to the stamp vendor is outside the scope of TDS provisions under section 194H.